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INTERRELATIONSHIP OF THE BANKING AND INSURANCE INDUSTRIES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE ISSUE OF BANK ENTRY INTO THE INSURANCE INDUSTRY AND WOULD CONSUMERS BENEFIT FROM NEW LIFE INSURANCE COMPETITION

JULY 29, 1987

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INTERRELATIONSHIP OF THE BANKING AND INSURANCE INDUSTRIES

WEDNESDAY, JULY 29, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Dixon, Sasser, Sanford, Bond, and Karnes.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

The minority, the Republicans, would like to be here this morning but they are necessarily absent because of the memorial services for former Commerce Secretary Baldrige who had such a tragic death over the weekend.

Today, we continue an ambitious series of hearings we began earlier this month on financial structure. During this and the four hearings that continue next week, we will consider the wisdom of remodeling the barrier between banking and other financial services.

In this session, we will address the specific issue of bank entry into insurance. The American insurance industry is the pride of the world, providing consumers with every conceivable type of coverage. The industry's financial power is formidable, controlling, for example, a vast empire of real estate.

Structurally, the insurance industry poses special problems. On the one hand, the industry has plenty of providers with some 2,134 life and health insurers, and 1,773 property/casualty firms. The property/casualty business is relatively unconcentrated, with 33 firms controlling half of the collective $264 billion in assets. Yet in the life and health insurance sector, only 11 companies control half the industry's estimated $800 billion in assets.

Would consumers benefit from new life insurance competition? A study by the Consumer Federation of America suggests that bank sale of this product can improve service.

Yet as this study itself notes, there are other concerns. Insurance, by nature, is a business of risks. Is it possible to insulate the bank's deposits from insurance underwriting? Should the insurance premium pool run dry, can we prevent the company from writing claim checks on the bank?

As Congress weighs financial law suitable for the 21st century, we must be mindful of the lessons of the 20th, 19th and 18th centuries. Does the legislative history that led to the adoption of the Glass-Steagall law bear on current circumstances?

And will the market benefit from mergers between industries, mergers that may lead to greater concentration.

We hear that financial services deregulation is "market driven." But who is it that tells us this? It is the market providers and producers, not necessarily the users. If the banking industry insists that the market demands they be allowed into underwriting securities, why isn't the National Association of Manufacturers, or the Business Roundtable, whose members represent the market for securities underwriting, banging on our door on behalf of the bankers?

If consumers demand so-called financial supermarkets, why aren't Sear's profits soaring?

Probably the greatest challenge, however, will be the ability to slice through the thick political fog that has engulfed these issues. While there are some 14,000 banks in the United States, there are some 20,000 independent insurance sales representatives in New Jersey. These insurance sales representatives may resist new competition on the self-interested grounds that it would reduce their profits. Yet bankers may hunger for the new business despite the fact that there are serious conflicts to consider. At the same time, existing laws were not written in a political vacuum.

We are days away from the August recess, but lest my colleagues grow bored as we return to our districts, I think that the hearings will provide plenty of summer reading fun.

At this point, statements of Senators Dixon, Sasser, Sanford, Bond, and Karnes shall be inserted in the record.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Banking Committee continues its background hearings on major financial services industry issues. Today, we will hear from consumer groups and State bank and insurance regulators on questions relating to the possible entry of banks into the insurance business. I look forward to hearing the testimony of the expert witnesses on these issues.

Before we begin, however, I would like to make a comment about H.R. 27, and the legislation which I hope will result from these hearings. H.R. 27, as everyone here knows, contains provisions imposing a moratorium until next March prohibiting the Federal banking regulators from acting administratively to provide banks with new asset powers in the securities, real estate, insurance, or options areas. The intent of this moratorium is to temporarily freeze the status quo to give Congress a chance to resolve financial services industry restructuring issues legislatively.

We have failed during the last 4 years to enact comprehensive reform legislation. It is not certain that we will be able to succeed this time. However, I do believe the Senate Banking Committee does genuinely intend to try to move long overdue reform legislation. Today's hearing is a demonstration of that commitment.

I hope all of the witnesses before the committee today, and all interested parties, will work with the committee during the moratorium period to come up with a good bill, one that will bring the law into line with the new marketplace realities.

I think it is important that we all work together now because H.R. 27 contains another feature that is vitally relevant to this debate: an expression of congressional intent that the moratorium not be extended past its scheduled March expiration date. There is often considerable skepticism about congressional pronouncements of this type. In my view, however, it means exactly what it says—we will not extend the moratorium. I want to take this opportunity to repeat what I have said before. I do not believe that the committee will extend the moratorium and I will do everything I can to ensure that it is not extended.

The moratorium is intended to provide an opportunity for more fundamental action. It is not a substitute for that action. It does not represent any kind of permanent solution to the problems facing the financial services industry today.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, I want to thank you for holding this second in a series of hearings on restructuring of the financial services industry. These hearings underline the commitment we made last March when the committee reported the "Competitive Equality Banking Act." We said at that time that we would use the next few months to conduct a comprehensive review of our existing banking laws. I am pleased to see that we are doing just that.

Today we consider the interrelationship of the banking and insurance industries, particularly to what extent banks should offer insurance products and services.

Mr. Chairman, there are a number of issues to be considered here. First, and foremost, what would be the benefits to consumers of expanded insurance powers for banks? Second, is there an increased potential for anticompetitive arrangements, such as tie-ins, if banks have insurance agency or underwriting authority? And last, would consolidation of the insurance and banking industries result in further economic concentration?

Mr. Chairman, I am looking forward to hearing the answers to these and other questions this morning. Thank you.

OPENING STATEMENT OF TERRY SANFORD

Senator SANFORD. I would like to commend the chairman for calling today's hearings. I would also like to thank our expert witnesses for appearing before us this morning so that we might benefit from their experience in the areas of banking and insurance.

From a reading of the testimony submitted by today's witnesses it appears that there is a general concensus that benefits could accrue to both consumers and banks if Congress were to allow banks to enter into the fields of insurance agency and possibly insurance underwriting. There is also general agreement that any such freedom must be accompanied by a careful regulatory review and that such a freedom would serve consumers best in a situation where commonly owned bank and insurance operations are segre-

gated under a holding company as separate subsidiaries where interaffiliate transfers are either strictly controlled or prohibited altogether.

I look forward to hearing your comments today as these hearings proceed because I feel that the question of whether banking and insurance functions can be safely and effectively combined is an important first step in a reexamination of our financial system as a whole. Such a reexamination if necessary and should occur within the coming year so that, going forward, we can dispense with the recent trend of "deregulation by loophole" and get on with the business of providing financial services in a safe and logical manner.

Thank you.

STATEMENT OF SENATOR CHRISTOPHER S. BOND

Senator BOND. I'd like to commend the chairman on the series of hearings he has put together on the broader issues involved with restructuring of the financial services industry. The testimony scheduled for the next 2 weeks from academics, consumers of financial services, and State regulators should provide us with valuable background as we wrestle with these issues.

I am pleased that Senator Proxmire has scheduled these hearings so that we can separate out genuine public policy concerns from attempts to preserve protected markets. These issues involve fundamental questions about how we want our economy to work. What sort of financial structure will serve American business best and create the most jobs? How can the need for safety and soundness in our financial structure be reconciled with the need for market discipline? How can consumers best be served? What sort of regulatory structure is best suited to monitor financial institutions involved in many different businesses all over the world?

There aren't any easy answers to these questions and I don't believe that this committee will have an easy time agreeing on a legislative program. Nevertheless, I am pleased that we are moving forward and I look forward to the testimony from today's witnesses.

STATEMENT OF SENATOR DAVID K. KARNES

Senator KARNES. Mr. Chairman, I would like to take this opportunity to thank all of the witnesses for taking the time to testify before the Senate Banking Committee. The financial restructuring of our Nation is a major policy challenge presently facing Congress as we attempt to restore confidence in U.S. financial institutions. The foundation of the American financial system has been under scrutiny for the past 5 years due to technical loan defaults and the decline of the energy, agriculture, and real estate sectors of our economy.

I am confident that your testimony will be beneficial in creating legislation which will determine the direction of our Nation's financial restructuring. I look forward to hearing the statements of today's two panels. During our deliberations over financial restructuring as relates to insurance and banking, it is good that we will have represented in our panels not just spokesmen for the tradi-

tional trade associations, but users of financial services, public officials and recognized experts on money and finance. With such numerous and diversified witnesses we will most effectively be able to assess the spectrum of issues affecting banking and insurance.

The CHAIRMAN. Our first witnesses are Robert Hunter, president of the National Insurance Consumer Association; and Mark Cooper, research director for the Consumer Federation of America.

We are delighted to have you gentlemen present and if you would like to summarize your statements we would be delighted to have them printed in full in the record.

Mr. Hunter, you go right ahead, sir.

STATEMENT OF J. ROBERT HUNTER, PRESIDENT, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. HUNTER. It's a pleasure to be here again, Senator. Its been several years since I appeared before you. I used to be the Federal insurance administrator.

The CHAIRMAN. I remember that. You were a fine witness and did a great job.

Mr. HUNTER. I appreciate that. We had a wonderful rapport at times.

NICO is here to support bank entry into insurance but we believe there needs to be controls on such activities. We think it would be good for consumers if this happened.

Competition is the national method of choice to protect consumers and insurance competition is currently less than required to guarantee consumer protection due to impediments to competition such as prohibition on entry by banks.

Banks would be a tremendous source of insurance for consumers under proper constraints. Sales outlets would be convenient and would be extremely efficient points of sale and particularly in the long run I believe they should be allowed to underwrite because where we need competition is with the direct writers of insurance.

There has been over many years a significant concentration in the insurance business into the direct writing end of the market, and that is a very difficult market to enter. There are entry barriers due to economics and common law rules.

Banks could enter at the direct writing level and that would be a boon to competition.

We think a level playing field is appropriate. Insurance companies own banks. We think the banks should be permitted to own insurance companies.

LIABILITY INSURANCE CRISIS

As this committee is well aware, in the last 2 years there's been a great liability insurance crisis. In part, the insurers have said that the problems have been created due to lack of capacity. The shortfall has been estimated as much as $60 billion by the insurance industry and yet they resist the availability of new capacity that banks could make and that could free up capacity to ease some of these capacity shortfalls that occur periodically.

The questions, though, of who should regulate and what consumer protections are very serious and need to be addressed. We

think the States should regulate the insurance activities of banks and we believe that, therefore, they should be walled off and separate operations within the bank holding company or within the bank choosing to sell or underwrite insurance. This would be consistent with Federal policy vis-a-vis insurance regulation for other types of insurance operations.

Sales of insurance is a low-risk business. Underwriting of insurance is more risky and is an average risk business, and I show the empirical evidence in my prepared statement of that.

Regarding consumer protection, the most important concern consumers have is the potential tie-in with sales. Interesting to us is that under title VI of Garn-St Germain you do allow banks to sell credit life and credit insurance which is of course one of the areas where tie-ins are most likely.

We think credit insurance, particularly credit life, has been very bad throughout the Nation and that through the process of reverse competition credit life insurance is overpriced in most States.

New York is an example of one State that has been able to control the price through regulation. The problem with credit life is that the real purchaser is the bank or the car dealer or whoever is making the loan, and the kickback or commission gets so big that the price goes up. Prudential has testified around the country, "We can't compete. Our price is too low." And so that's a serious problem and yet that's allowed under the current rules and that's probably the area where the problem would be the worst.

On the other hand, lenders have done an excellent job selling life insurance in New York and other States, that is the so-called savings bank life insurance, that has been a consumer boon. So properly structured, you can have an excellent outcome. Improperly structured, we think you wouldn't.

Therefore, we think there should be rules controlling the behavior of banks to control the tie-in problem. We think there ought to be notices that insurance can be bought elsewhere and that any loan is not conditioned upon purchase of insurance and that there ought to be a certification of the knowledge of that by the person getting the loan and the insurance in the same place.

There ought to be a cooling-off period. We think that price information should be made available generally so that the person getting the loan can see how expensive or inexpensive the bank offer is, and we think that those provisions ought to be extended to cover the current credit insurance that's already being offered because that's where the abuses are.

Will there be undue concentration of economic power if the financial services are merged? We can't tell you whether from the entire national picture there would or would not be, but as respects insurance, there is significant concentration occurring already. We believe bank entry in the long run would in fact lower concentration, not raise it, in insurance because there is a movement toward the direct writers and there is significant concentration.

So NICO believes that properly controlled bank entry into insurance has the potential of being a boon to insurance consumers. This entry, coupled with application of antitrust laws to insurance, which your fellows in the Judiciary Committee are looking at,

would maximize competitive pressure in insurance to the benefit of the insurance consumer.

So we encourage this committee not to continue to block competition in insurance but to at least allow the States to determine if they want to allow banks and bank holding companies to provide insurance services.

Another problem that I find in the current rules is that small bank holding companies are allowed to sell insurance but the larger bank holding companies are not. That makes no sense if it's a risky business.

Finally, in closing, the Judiciary Committee is looking at the McCarron-Ferguson Act and there the insurers argue very strongly that the Federal Government should not meddle with the States and somehow they argue that the repeal of their right to fix prices would meddle with State regulation. I happen to disagree with that, but that's their argument.

Here, they make a 180 degree flip-flop and argue for you to meddle with States rights and overrule States. What's consistent in their argument, of course, is in both cases they are arguing against increasing competition.

I think the insurance industry has been coddled by Congress for many years and probably the banks too. I would ask you to do us all a favor and let them go head-to-head.

[The complete prepared statement of J. Robert Hunter follows:]

The CHAIRMAN. Thank you, Mr. Hunter.
Mr. Cooper.

STATEMENT OF MARK N. COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

Mr. COOPER. Thank you, Mr. Chairman.

CFA's policy on expanded entry into insurance is as follows. CFA opposes anticonsumer and anticompetitive restrictions on purchase of savings bank life insurance. We support entry of additional sellers in competition with insurance companies and agencies, subject to regulatory oversight to assure fiscal responsibility and honest sales practices.

That policy has been on the books for about half a decade. As part of a continuous review of our policy positions, CFA has recently conducted a literature review and survey of life insurance sales practices.

We came out just about where we started. If properly regulated and safeguards are put in place, bank entry and sale of life insurance can be a boon to consumers. If it is not well-regulated, consumers will lose.

If regulation is too light-handed, bank customers could suffer. If it is too heavy-handed, the potential benefits to insurance customers would be eaten up by regulatory costs and obstacles.

Of course, in the current context, there are serious doubts about whether regulators at the Federal and State levels are up to the task of implementing the complex sort of regulations that would be required.

Our research leads us to these conclusions for the following reasons.

First, those banks currently in the market behave better from a consumer point of view. They price more favorably and market more openly. This suggests significant potential benefits from wider bank sale of insurance.

Second, however, why they do behave better and whether their behavior can be extrapolated to other banks is not clear, especially to the big commercial banks. We only have small savings banks, small programs. We don't have big banks. There's evidence on both sides of how the bigger banks would behave.

We presume that where economic institutions and corporations have market power, they will exercise it. In the banking industry, our literature review shows that there are at least three bases for this market power with banks—concentration, access to cheap money through Federal deposit insurance and the discount window perhaps, and also the potential for tie-ins.

Bank sale of insurance could open these three potential avenues for the exercise of market power.

We also believe that banks are special institutions which provide vital economic infrastructural functions under a franchise and, therefore, there is a social obligation to ensure the safety and soundness of these institutions. Expansion into sale of insurance could threaten that soundness.

Therefore, Congress cannot simply open the floodgates to allow banks to enter and have Congress walk away. It would be neces-

sary to provide regulatory safeguards to protect both banking and insurance consumers and the banking industry.

There are about a half a dozen policies we believe should be implemented. Separation of banking from the insurance business, limits on the size of the insurance company relative to the overall bank, perhaps restriction of sale of insurance to State-chartered or savings banks, a cooling-off period after the purchase of a bank insurance policy, and the stipulation that an equivalent policy must be acceptable if in fact the insurance is related to a loan.

We might also preclude the offer of insurance prior to the conclusion of a separate financial transaction. That would, of course, break the potential tie into sequential financial transactions.

Finally, we believe that there should be rigorous disclosure so that consumers have the best information available to them in making their purchase choices.

That there is a serious problem in the pricing and provision of life insurance is clear on the basis of our research. That bank sale of insurance could help consumers and alleviate some of the problems we think is also clear, but banks are certainly no cureall and allowing them to sell life insurance does not come without serious potential problems.

If banks were allowed to simply enter and sell life insurance, they are likely to specialize in a segment of the market that places a very high value on convenience and is also probably extremely price conscious.

Although it seems clear that they could be low-cost providers to this particular market segment, it is not clear that they would pass all those savings through and we would be foolish to think that they would. They would capture some of their low-cost advantages in terms of increased profits.

If it could be assumed that savings banks and all banks would not engage in cross-subsidy risk-shifting or rent seeking or coercion, then there would be a major benefit to consumers. But it cannot be simply assumed that these negative behaviors from the consumers' point of view will not take place. Quite the contrary is the case.

Therefore, we believe that the regulations we have proposed would augment the infusion of competition, protect consumers, and serve both the consumer and the public interest.

Thank you, Mr. Chairman.

[The complete prepared statement of Dr. Mark N. Cooper follows:]

STATEMENT OF

J. ROBERT HUNTER
PRESIDENT
NATIONAL INSURANCE CONSUMER ORGANIZATION

BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE

BANK ENTRY INTO INSURANCE

JULY 29, 1987

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BANK ENTRY INTO INSURANCE

INTRODUCTION

Mr. Chairman and Members of the Committee, I appreciate your invitation to appear before you today to discuss our views regarding bank entry into insurance and the safeguards necessary to protect consumers if such entry occurs.

I am J. Robert Hunter, President of the National Insurance Consumer Organization (NICO) and a former Federal Insurance Administrator, in which role I appeared before this Committee on many occassions, with mostly fond memories, Mr. Chairman.

NICO POSITION

It is NICO's belief that the barriers between financial institutions should come down. There is no justification, in our view, for prohibiting competition among concerns that meet economic and other standards for such activities. This is not to say that there should not be careful consideration of ways to control potential abusive practices, but it is to say that once those structures are worked out and in place, no artificially imposed impediments to competition should be allowed to exist. Specifically, NICO supports bank entry into insurance, with controls on such activity.

RATIONALE

Competition is the national method of choice to protect consumers. Insurance competition is less than required to guarantee consumer protection due to impediments to competition such as prohibition on entry by banks into sales or underwriting of insurance as well as lack of antitrust law enforcement.

Banks are a logical source of insurance. Sales outlets in banks would be convenient for consumers and should be extremely efficient points for sale. The incredible reaction of insurance agents against bank entry is due in the main to their inefficienty and high cost.

The agents are already sharply losing market share to the direct writers of insurance, but bank entry, agents rightly fear, would hasten their demise.

Ultimately, banks should also be allowed to underwrite, I believe. They have great potential to be very competitive underwriters. Entry into the agency writing (insurance) business is relatively easy, but entry into the direct

writing business is not. Entry barriers are inherent in both the economics of direct writing and in the legal barriers resulting from old common-law rules. Direct writing requires an extensive distribution system whether through employees or exclusive agents, and a substantial public-name recognition. This all requires substantial initial funding.

A legal barrier is the common-law rule that the 'property rights' of an insurance consumer belong to the agent, not the company, so that an existing agency company cannot move with its existing insureds into the direct writing business.

Indeed, the Insurance Company of North America (INA) attempted to enter the direct writing field but was forced to give up the attempt when its agents threatened retaliation just a few years ago. Consequently, entry into the dominant part of the industry, the part marked by relatively high concentration for private passenger auto insurance, for example, is not easy. The ease of entry into agency writing benefits consumers only if new entrants can make their presence felt at the consumer level through price and other competition. To the extent that agency writing companies use or track bureau rates, competition from this segment of the industry is reduced; it is also reduced by resale price maintenance, inadequate consumer information, reverse competition, and investment income underwriting.

Banks with underwriting authority could enter at the direct writing level. Such a development is a potential boon to competition in insurance.

Equity argues for the level playing field everyone seems to want; it is simply inappropriate not to let some of the teams on the field. Insurance companies today own banks; security dealers own banks and insurance companies; insurance companies own securities dealers. Why should the banks be prohibited from doing what the other entities are doing? There is no justification for that.

As this Committee is well aware, in the last two years the nation has been through a great liability insurance crisis particularly impacting commercial lines of insurance. The insurers blamed this crisis, in part, on insufficient capacity (i.e., capital and surplus). The President of the Insurance Servicefs Office has estimated that the capacity shortfall is of the order of $60 billion. 1/ Bank entry into insurance underwriting would help to ease any capacity shortfall. I believe that banks would likely first underwrite personal lines of insurance (like auto and

1/ Daniel J. McNamara, President of Insurance Services Office, quoted in National Underwriter, March 8, 1985, p. 1.

homeowners) rather than commercial accounts, but capacity is fungible and the traditional insurers could free up more capacity for commercial insurance.

In order to gain the maximum benefit of bank entry, both sales and underwriting by banks should be allowed, with regulatory controls discussed below.

REGULATION

Who will regulate the insurance activities of banks? We believe that the states should do so and that the insurance activities of banks can be sufficiently segregated to accomplish this goal. We support a totally walled-off insurance operation within banks choosing to sell or underwrite insurance, to accomplish this regulatory treatment. This is consistent with current federal policy vis-a-vis insurance regulation, for other owners of insurers or insurance agencies.

The sale of insurance is a very low risk business. If you sell you get commissions, if you don't, you don't. It is difficult to imagine how banks could be financially hurt by expanding their authority to the sale of insurance.

The underwriting of insurance is more risky. Economic studies, however, indicate that it is not a high risk business but only an average risk enterprise. This is to be expected because the law of large numbers (that is, the more risks you underwrite the higher the predictability of such activity) works and the lack of antitrust law enforcement enables insurer price-fixing to occur. The empirical measures of risk confirm the average riskiness of underwriting. Exhibit 1 shows a study of these indicators. A beta coefficient of 1.00 would imply average riskiness. Insurance is slightly below average.

Other analytical data also demonstrate that insurance common stock investments are less risky than investments in other industries. For example, Value Line (a stock market advisory letter) publishes indices of safety, price stability and the predictability of earnings for a wide variety of firms in all sectors of the economy. As shown in Exhibit 1, in terms of safety, the insurance industry has an average safety index of about 2.5 on a scale from 1 to 5 where 1 is the highest safety rating. Also, price stability ranks at the upper end of the scale from 5 to 100, where 100 is the highest stability rating. Finally, the insurance industry's average earnings predictability index is slightly higher than average on a scale from 5 to 100 where 100 is the highest predictability rating.

In summary, then, not only is it logical to conclude that investments in other enterprises are not less risky than investments in the property/casualty insurance industry, financial and analytical empirical tests prove that is so.

CONSUMER PROTECTION

The concern most obvious to insurance consumers is the potential for tie-ins. It has been alleged that if banks came into the insurance business, they would use their financial leverage to require insurance of people who seek loans. Do not minimize the concern that consumers have about this practice. Indeed, the tie-ins that insurers themselves engage in are somewhat of a problem. For instance, it is quite common for an insurer to require homeowners insurance as a condition of writing auto insurance. 2/ The problem requires careful consideration by regulators as to how to assure that these practices do not occur. Banks do not have clean hands in their current activities. Credit life insurance is an abomination throughout most of the nation. But the successful control of rates in the state of New York shows that these practices can be mitigated by courageous regulation. However, most states have not been able to overcome the tremendous lobbying pressure of banks and other lenders, car dealers and insurance companies to mitigate abusive practices and monumental commission deals.

On the other hand, lenders have done an excellent pro-consumer job in supplying savings bank life insurance in several states. Historically, these policies have been inexpensive, pro-consumer and without charges of tie-in practices. When we think about all lines of insurance, most of them do not relate to tie-ins. There is no tie-in that I can envision if a bank sells health insurance. The tie-ins on car loans and home loans would be at the first policy term only and agents and others would be free to compete for renewal policies even if an initial tie-in occurred. But even the initial tie-in can and should be avoided.

NICO suggests that bank entry into insurance be accompanied by certain rules controlling their behavior, such as:

- a requirement of a notice that insurance can be bought elsewhere and purchase from the bank is not a condition of any loan be very clear and precise and in bold, colored print on loan documents;

2/ See attached letter (Exhibit 2) from Allstate Insurance Company to its client in which it requires auto and homeowners insurance as a condition for an umbrella policy.

- a requirement that the notice be sent out when any insurance policy which covers a loan is delivered, for certification by the purchaser that he or she understands that he or she is free to purchase insurance elsewhere;

- a requirement that a cooling-off period run for all policies from the date of delivery for 15 days;

- a requirement that price information be made available by phone to the public by all insurance underwriting and sales facilities (not just banks); and

- a requirement that these protections be extended to current credit related insurance sales by lenders, such as credit life insurance.

CONCENTRATION

Will there be undue concentration of economic power if financial services are merged? It is beyond the scope of our expertise to determine if bank entry would cause undue concentration at the banking level. As respects insurance, we think significant concentration in insurance is inevitable whether or not banks enter insurance. There are hundreds if not thousands of inefficient insurance companies able to continue to exist because of the lack of meaningful competition in the insurance business under what President Ford's Justice Department and President Carter's Commission on Anti-Trust Laws and Procedures found was an overly broad anti-trust exemption under the McCarran-Ferguson Act, the subject of intense review by the Judiciary Committee currently. I believe that instead of 5,000 insurance companies as we have today there will only be 500-1,000 by the year 2,010 even if there is no financial service integration. Because of the difficulty in entering the direct writing business and the large price advantage these few direct writers have, concentration has been increasing in the property/casualty insurance industry for at least three decades. After thirty years, the trend has produced the predictable result. Major lines of insurance are far more concentrated than in the 1940's, and many state markets are concentrated at oligopoly levels.

Current data indicate uniformly higher levels of concentration compared to the concentration levels reported a decade ago. As shown below, the 4-firm state market share is significantly higher than 10 years earlier, and most states have 4-firm shares in excess of 50% for one or both auto lines:

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Average 4-Firm Concentration Ratios

	Homeowners	Auto Liability	Auto Physical Damage
1978	32.6%	39.2%	37.8%
1980	43.6%	49.8%	49.5%

Also, in contrast to circumstances ten years ago, today most homeowners markets and almost all auto markets are sufficiently concentrated to conform to the traditional broad definition of oligopoly: 3/

Number of States With Oligopoly Markets

	Homeowners	Auto Liability	Auto Physical Damage
1971	16	20	30
1980	38	50	48

Similarly, while there were no states with highly concentrated markets under a more strict test 4/ in 1971, there are now 27 highly concentrated state-product markets; and 12 more are borderline. 5/

3/ Kaysen and Turner have defined an oligopoly market as one where eight firms have 50% of the business, and 20 firms have 75% or more. These are referred to as the eight-and twenty-firm ratios.

The few states not concentrated in auto lines are smaller states where the markets fall short of being concentrated by only slight amounts. Kentucky (phys. dam., 55.5%/74.9%); New Hampshire (liab., 49.0%/80.1%; phys. dam., 46.5%/78.3%); North Carolina (phys. dam., 50.9%/74.6%).

4/ Dr. Willard Mueller defined an oligopoly market as one with four- and eight-firm ratios of 50% and 70% respectively. Monitoring Competition at 26.

5/ A state is borderline if it falls short of the high concentration boundaries by a total of no more than 2 percentage points (e.g., 48/70, 49/69, or 50/68), so that at present trends it will cross the high concentration line by the end of 1982.

Number of Highly Concentrated States

	Homeowners	Auto Liability	Auto Physical Damage
1971	0	0	0
1980			
Very high	4	14	9
Borderline	2	5	5

The states that are highly concentrated in both auto lines include a number of major open competition states, such as California, 6/ Michigan, and Virginia.

While more research is needed, I believe that, in the long range, concentration will be reduced and jobs saved (although changed) by the allowing of banks to come into the business of insurance given the thousands of banks with the potential to be competitive insurance providers.

SUMMARY

NICO believes that properly controlled bank entry into insurance has the potential of being a boon to insurance consumers. Their entry, coupled with application of antitrust laws to insurance (something banks support but insurers continue to oppose) will maximize competitive pressures in insurance.

The necessary controls are:

- wall-off insurance operations of banks and allow the states to regulate it;
- control tie-in sales through such standards as precise disclosure, cooling-off periods and certification of consumer understanding of his or her rights;
- extend tie-in protection to currently sold credit-related insurance, such as credit life insurance; and
- facilitate shopping by consumers and reduce tie-in potential by requiring insurer price disclosure.

6/ The California data recognize the fact that two major insurers do not compete in each other's territories, and, for competitive purposes, they are treated as one. Even without that adjustment, California is highly concentrated in liability insurance under the strict test (55.0%/70.5%) and almost so for physical damage (55.1%/68.8%).

We encourage this Committee not to continue to block competition in insurance but at least to allow the states to determine if they want to allow banks and bank holding companies to provide insurance services. We believe that insurance consumers will benefit from this step.

I will be happy to answer any questions you may have.

EXHIBIT 1

Risk Indicators

Company	Beta Coefficient	Safety Index	Price Stability Index	Earnings Predictability Index
AETNA	1.10	2	75	50
American General	.80	2	85	65
American Intl.	1.00	3	80	100
Chubb Corp.	.80	3	80	30
CIGNA Corp.	1.05	2	75	90
Continental Corp.	.95	1	85	45
Crum & Forster	1.05	3	65	60
Farmers Group	.90	3	80	95
Geico Corp.	.95	3	45	15
Kemper Corp.	.80	3	60	55
Ohio Casualty	.95	3	80	50
SAFECO Corp.	.90	3	90	45
St. Paul Cos.	.85	3	85	55
Travelers	1.05	2	75	60
USF&G	.85	1	90	45
Average	.93	2.5	77	57

Source: Value Line Investment Survey.

EXHIBIT 2

Allstate

California Regional Operations Center
P.O. Box 25115
Santa Ana, CA 92799
714-579-8759

Date: March 30, 1987
Policy Number: 04 838 533
Type of Policy: Personal Umbrella
Termination Date: June 17, 1987

Richard E. Rosengarten
8535 W. Knoll Drive 212
W. Los Angeles, CA 90069

Dear Mr. Rosengarten:

Recently, much has been said and written about the liability problems affecting society today. While most of the impact has been felt in the business and professional community, it has not left untouched families and individuals.

As a holder of an Allstate Personal Umbrella Policy (PUP) you have already recognized the need for excess coverage to protect your financial assets to a greater degree than that found in a normal auto or homeowner policy. Allstate wants to continue to provide this valuable protection for you. However, due to the tremendous increase in the number and cost of liability claims, we find it necessary to require that the primary liability coverages afforded by the homeowner and auto policy be with Allstate.

This is necessary for two reasons. First, it is extremely difficult for us to continually verify the required underlying auto or property coverages if they are with another company. Second, when two companies are involved in the same claim, problems can occur. For example, if your primary liability limits are with another carrier and a large claim occurs, we may not even be aware of the claim until the primary limits are exhausted. Therefore, we may be bound by the claim procedures and practices of the other company, one result possibly being less than ideal claims service to you.

In reviewing your Personal Umbrella Policy records, we find that the primary policies (Automobile and Homeowners) for which the Umbrella Policy provides excess liability, are not presently carried with Allstate. We are therefore unable to renew your protection under the Personal Umbrella Policy shown above and it will expire at 12:01 a.m. on June 17, 1987.

Please note this action does not change the status of your current (auto or property) policy. If you desire to continue your PUP policy with us, please contact your Allstate agent immediately. It is our sincere hope that we can continue to provide this coverage for you.

Cordially,

U. Newman
Allstate Insurance Company

cc: Rick Oksas Loc 523

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The CHAIRMAN. Thank you, Dr. Cooper.

VOLUNTARY TIE-IN SALE

Mr. Hunter, the principal argument made by insurance agents against allowing banks to sell insurance is the problem of the voluntary tie-in sale.

The agents argue that even though banks may not directly require their customers to buy insurance as a condition for getting a loan, as a practical matter, the customer will voluntarily decide to buy insurance from the bank in order to enhance his or her chance of getting credit from the bank. This is especially clear on credit life insurance.

This gives the bank an unfair competitive advantage over independent insurance agents. The agents go on to argue that because the tie-in is voluntary on the part of the consumer there is no way it can be curtailed by regulation. They say the only solution is an absolute prohibition on banks selling insurance.

So what's your response to these arguments? Is the voluntary tie-in sale a real problem? Is there no way to deal with it by regulation?

Mr. HUNTER. I guess it's hard to regulate against voluntary decisions. I think the main reason you're going to find voluntary decisions in favor of banks against say independent agents sales would be probably their price will be lower.

To me, that is the key factor that most people——

The CHAIRMAN. Well, supposing their price is higher and supposing the implication is very clear—"Look, buddy, you get a loan if you buy the credit life insurance."

Mr. HUNTER. Then it's not voluntary.

The CHAIRMAN. Then the person who sells the life insurance to them, the loan officer, may get half the premium.

Mr. HUNTER. That's what happens in credit life insurance and, as I argue, that needs to be controlled. But it seems to me that if there is disclosure, if there is a cooling-off period, if there is some information about price, then the consumer is put into a position of having power; that is, of knowing what the options are and knowing that the loan cannot be conditioned upon buying insurance at the bank. Even at the delivery of the loan and the delivery of the insurance policy the consumer would have a cooling off period and could get rid of the policy.

So I think the protections against even a voluntary type of tie-in can be put in place. Now consumers may not choose to act on that, but I'm suggesting that that can be controlled and in the long run I believe the banks will compete with lower price, as they do in savings bank life insurance.

The CHAIRMAN. Dr. Cooper, you seem to be of two minds on whether the banks should be permitted to sell insurance. On the one hand, you believe more competition is needed in the insurance business, both in relation to companies and agents, and you think banks might provide it.

On the other hand, you see a potential conflict of interest in allowing banks into the business and you fear it may actually harm consumers unless it's properly regulated.

In that regard, you say on page 1 of your testimony, "Serious doubt about whether regulators at the Federal and State levels are up to the task of implementing the complex sort of regulations that would be required."

Well, let's get to the position that we as Senators are members of this committee. If you were on this committee and you were Senator Cooper, would you vote to permit banks to sell and underwrite insurance or not?

Mr. COOPER. Well, if I were certain that the final vehicle had the regulatory protections, I think the regulatory program that we have outlined, effectively implemented, would in fact protect consumers.

Does that regulatory program get to the finish line and signed by the President? If that's the case and if we have the oversight at the Federal or the State level that's necessary to get those regulations implemented, I do think there is a benefit.

But those are two questions that Senators answer, is whether or not they believe they can write those regulations and get them signed into law and then whether or not they believe their influence over the regulatory system is adequate to ensure that they will be effectively implemented.

We do have cases—I think the State of New York is a good case where you have a vigorous regulatory system that has an impact on the industry and we believe protects consumers. There is no doubt there is a judgment about whether or not you believe, as a Senator and as a Congress, we can get those regulations in place and implemented.

The CHAIRMAN. Mr. Hunter, you say on page 31 of your testimony that both sales and underwriting of insurance by banks should be allowed.

Mr. HUNTER. Yes.

The CHAIRMAN. On that same page you say, "The sale of insurance is a very low-risk business." And then later you say, "The underwriting of insurance is more risky."

Would it make sense, in your view, if we wanted to approach this in a cautious way, if we were to let banks get into insurance to start with the less risky sales area and if that goes well consider the underwriting?

Mr. HUNTER. I think yes, sir. I think that's probably what would happen even if you opened the door all the way anyway because I think the banks would want to gain experience through that sort of an approach.

But I think, yes, that it would be a reasonable exercise to go one step at a time. I believe ultimately in the long run, both steps are appropriate.

The CHAIRMAN. When you say one at a time, perhaps this Congress might permit the sales area and then underwriting possibly later.

Mr. HUNTER. At a later time, looking at the experience of the sales and making sure that the problems of tie-in and what-not are not abusive.

The CHAIRMAN. Senator Bond.

Senator BOND. Thank you very much, Mr. Chairman.

I apologize for not being here at the beginning to present an opening statement. I do want to commend you for this series of hearings bringing in representatives of consumers, representatives of State regulators and academics, to provide us with the valuable background on how we should deal with these issues. I think that the hearings give us the opportunity to separate the genuine public policy concerns that we must deal with in this area from attempts simply to preserve protective markets, and I would like to submit my statement for the record.

The CHAIRMAN. Without objection, it will be printed in full in the record.

Mr. Hunter, to go back to the credit life, this is an area which has generated a great deal of controversy at the State level as well as before this committee.

Tell me to what extent you feel that courageous regulation really can do an effective job in preventing abuses. Do you see examples and where do you see them and how does it work?

EXAMPLES OF REGULATION

Mr. HUNTER. Well, for example, I mentioned in my testimony, I think the State of New York has been able to accomplish that by putting a cap on the rate. Now most States have a cap on it, but the cap in a lot of States are three or four times the cap in New York and all the rest of that is essentially being used to finance kickback type commission deals.

But New York has done it, so it is doable. And many States have moved strongly. But it's very difficult. There is a combination of insurance companies and banks and car dealers who profit from this who are a rather formidable lobbying group at the State level and have been able to undo in some instances positive legislation and positive regulations to keep these high rate levels in place.

But it can be done because New York has done it.

Senator BOND. Do you feel that the voluntary selection or the voluntary tie-in might not still be a factor even if the caps were brought down to the going rate of credit life insurance? When a borrower is at the bank and is advised he has to have credit life insurance, if he can get the same rate isn't there a natural tendency to choose credit life when you can buy it at the next desk or maybe at the same desk?

Mr. HUNTER. Oh, sure. I think one-stop shopping is obviously something consumers like, too. I think that's why Allstate has moved in that direction, for example.

But I believe this voluntary tie-in argument is not accurate. For example, in the other example of savings life insurance, we find a very procompetitive, very low price out there actively competing with other insurance very effectively.

In health insurance, it's almost impossible, for example, if a bank wanted to offer health insurance, to figure out a tie-in to sell health insurance.

So some lines of insurance have no potential for tie-in. The current Federal policy is you can't write insurance except credit-related insurance, which sort of sounds to me just the opposite——

Senator BOND. Is that backward?

Mr. HUNTER. It sounds backward. It sounds like it ought to be the other way around, if you were working from a basis of logic.

Senator BOND. Well, isn't it true that the banks generally—and I ask this because you have a much broader base of knowledge than I do—really are more passive sellers of insurance and more likely to have it available? They don't have a force of agents going out selling the insurance.

Mr. HUNTER. Well, they would be able to market and I think they would probably start with sales alone and I think they would probably start in personal lines of insurance because that's the people who come through their doors. So I would expect that's where the fundamental competition would begin.

I think they would advertise. I think they would be able to obviously advertise to their own clients because they have their mailing lists and so on and I think they would take advantage of that. But I don't think they would be just passive.

Senator BOND. But I guess the bottom line is you feel that you do not have, from your organization's standpoint, objections to the banks continuing to offer credit life so long as there is this courageous regulation?

Mr. HUNTER. Well, what I said in my statement and I think what my position is, is that controls the Congress would put on it, disclosure and other controls, should apply not only to the newly available insurances that you would allow banks to sell, but also to the credit life that they are currently selling, because that's where the abuses occur.

Senator BOND. My time is up. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bond.

Mr. Cooper, you seem to draw a distinction between letting banks sell life insurance on the one hand compared to property and casualty insurance on the other. Are you drawing a distinction between these two products and are you suggesting that there could be more serious problems involved in letting banks sell property and casualty insurance?

Mr. COOPER. No. The reason we have focused in our statement on life is that that is what we have recently been examining, the sales practices. I would not draw a distinction. We have been looking in great depth at the question of life insurance only, but I would tend to agree that banks should be allowed to sell other forms of insurance, although I've heard that they are not running to get into property and casualty. They would like to get into life first, as I understand it.

But we have been focusing on life as a research issue, looking at that specific policy. That's the only reason I focused on it.

The CHAIRMAN. Now I congratulate you on the quality of your study. I think it's the best we have to date on the question of deciding on bank entry into insurance.

But with all the good study and with your study too, you're very modest in your conclusion. In fact, you kind of leave it up in the air. You say, "If regulation is too light-handed, bank customers will suffer. If it is heavy-handed, insurance consumers will be eaten up."

So let me ask you, given you the problem of crafting such carefully balanced regulation, should we simply leave the system as it is?

ONE STEP AT A TIME

Mr. COOPER. Well, one way to change the system—and I think Mr. Hunter suggested it—is to take one step and then the other. I think there's much less of a threat to the banking system if you get into the agency side—if you allow the banks to sell but not underwrite. And there has been some movement in some States in that direction.

The possibility is to take the first step which does not pose a great risk and see what develops, to see whether or not some of the negative potential problems develop. And if they don't, then to consider the second step.

That the research ends up up in the air reflects the fairly uncertain weight of evidence on both sides of the question. The two possible ways is, first, to try and craft that regulation. The regulation does exist. It is out there. But this has been a deregulatory age and writing careful regulation is not a frequent process in Congress. The second possibility is to allow sale but not underwriting and see how sale goes.

The CHAIRMAN. Now, Mr. Hunter, again, I certainly applaud your well-researched testimony. I think it's excellent, but I'm especially interested in the issue of concentration and I'd like you to expand on your comments.

You say, "Lack of meaningful competition has spawned a large number of inefficient insurance underwriters." That's kind of a novel view of the force of competition. Doesn't competition go hand-in-hand with the presence of a large number of competitors? To continue on this, you suggest that bank entry will invigorate competition. Won't it be possible the banks will simply become part of the oligopoly that you say prevails in some States as opposed to oligopoly-busters?

Mr. HUNTER. Well, there are thousands of banks and there are only a handful of direct writing insurance companies where the concentration is occurring. If the banks could enter, which my point was, at the direct writing level as underwriters and sellers ultimately, I think they would be in direct competition with where the real competition occurs.

What I'm suggesting is, because of the serious problems in consumer information and other problems in the insurance industry, including the exemptions from antitrust law and price-fixing arrangements, there is a significant degree of inefficiency in the market.

Having a great number of competitors is wonderful if they are efficient and competing and going toward the low cost price, but we don't see that here.

The CHAIRMAN. If you have a large number of competitors, just by the action of the market itself, the efficient competitors would emerge and dominate and would kind of set the pace as they do in other areas. It's hard for me to understand how you get more competition by having fewer competitors.

Consumer Federation of America

TESTIMONY OF DR. MARK N. COOPER
DIRECTOR OF RESEARCH
CONSUMER FEDERATION OF AMERICA

before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

on

CONSIDERATION OF BANK ENTRY INTO INSURANCE

July 29, 1987

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121

Mr. Chairman and Members of the Committee,

My name is Dr. Mark N. Cooper. I am Director of Research of the Consumer Federation of America (CFA). CFA, which was founded in 1968, is the nation's largest consumer advocacy organization. CFA's membership encompasses more than 200 national, state and local consumer, senior citizen, low-income, union, farm, labor, public power and cooperative organizations representing more than 35 million people.

We have long been concerned about both the banking and the life insurance industries and we have recently conducted a large scale research project into life insurance sales practices. I submit for the record the two reports summarizing that project and I appreciate the opportunity to present our finding today.

CFA'S POLICY ON BANK SALE OF INSURANCE

CFA's policy resolution on expanded entry into the insurance field is as follows

> CFA opposes anti-consumer and anticompetitive restrictions on purchase of savings bank life insurance. We support entry of additional sellers in competition with insurance companies and agencies, subject to regulatory oversight to assure fiscal responsibility and honest sales practices.

That policy has been on the books for about half a decade. As part of a continuous review of our policy positions, CFA has recently conducted an exhaustive literature review and survey of life insurance sales practices.

We have come out just about where we started. The dilemma facing consumers and policymakers is that the current regulation and structure of the insurance industry leave a great deal to be desired. Bank entry might capture unique benefits associated with direct bank sale of insurance and it might also drive the industry to perform better as a whole. But there is a serious question about whether regulatory and institutional changes can be implemented that would allow banks to sell insurance without burdening the banking system or destroying the potential benefits to life insurance consumers.

If regulation is too light handed, bank customers will suffer; if it is too heavy handed, the potential benefits to insurance consumers will be eaten up. Moreover, in the current context, there are serious doubts about whether regulators at the federal and state levels are up to the task of implementing the complex sort of regulation that would be required.

BACKGROUND TO THE LIFE INSURANCE RESEARCH PROJECT

Let me briefly review how we reached that conclusion.

In our first report we published the results of a survey of life insurance agents which concluded that agents were extremely reluctant to provide cost information and that the policies received in the mail were vastly overpriced. That report recommended a review of federal and state antitrust policies which grant the insurance industry exemptions from or diminish government oversight of its business practices.

Allowing banks to sell insurance is another policy that has frequently been mentioned as a way to impose greater discipline on insurance companies and to provide consumers with more cost-effective choices. Our research project reviewed the potential benefits and costs of allowing banks to underwrite or broker life insurance.

As part of a survey of 262 life insurance agents, fifty-six bank-based sellers of life insurance were contacted in an effort to purchase life insurance.

In addition to the cost comparisons made on the basis of policies received in the mail, a large data set was compiled to conduct an econometric analysis of policyowner costs.

An extensive literature review was conducted to ascertain whether there are economic grounds on which a cost difference between banks and insurance companies might rest.

The literature review also identified a number of potential problems that might be associated with bank sale of life insurance.

THE POTENTIAL BENEFITS: POLICYOWNER COST AND CONSUMER INFORMATION

A predicate for even considering bank sale of insurance is the possibility of some benefit to consumers. If there are no potential costs savings or improvements in consumer purchase patterns, there would and should be little interest in considering bank entry into insurance.

A number of studies of policyowner costs of life insurance have been conducted which permit the comparison of bank and non-bank life insurance, as well as the assessment of the effects of regulation. Consumer Reports has done a series of surveys in which savings bank policyowner costs have been consistently lower. This is true in a number of other studies from the 1970s and 1980s.

In the 1986 survey conducted by Consumer Reports savings bank life insurance is considerably lower than the offerings of the other companies. The policyowner cost of savings bank life insurance is, on average, almost 30 percent less than all other companies. The policies sent to us in response to our survey replicate the CR results.

The econometric model we developed to control for a variety of factors including underwriting and lapse experience, expense ratios, profits, size, age and ownership of the firm, marketing approach and policy specialization, corroborates these findings. Savings banks have lower policyowner costs and the higher the percentage of states in which a company is licensed that allow bank sale of insurance, the lower its policyowner costs tend to be.

The literature review establishes a clear economic basis on which potential cost savings to consumers might be based -- including economies of scale, economies of scope and potential complementarities between the profit streams of the banking and insurance businesses. Insurance subsidiaries of financial and non-financial companies have lower operating costs and lower policyowner costs.

The survey of agent sales practices also shows that banks are more responsive to consumer requests for information.

> Eighty-four percent of the banks were willing to discuss exactly the policy the consumer inquired about, compared to fifty-six percent of the agents.
>
> Approximately a third of the banks gave the Interest Adjusted Net Cost Index (IANCI), the insurance industry's standard pricing index, compared to less than a fifth of the agents.
>
> About eighty percent of the banks gave either IANCI or guidance on cost comparisons, compared to about two-thirds of the agents.
>
> Almost two thirds of the banks mailed information on the desired policy whereas just over one quarter of the agents did.
>
> Banks were three time more likely to mail the Interest Adjusted Net Cost Index.

THE POTENTIAL DANGERS IN BANK SALE OF INSURANCE

While this evidence suggests that banks do sell insurance more cheaply and are easier to deal with, four major areas of potential costs to consumers emerged in the literature review. Ranked in declining order of seriousness, as we see it, the problems are safety and soundness, concentration, coercion and point-of-sale service.

Safety and soundness is a concern that banks may pursue high risk, high return activities placing the banking system at risk.

> The higher rates of return possible in the insurance business come with higher levels of risk and, unrestrained, banks are likely to pursue these high risk/high return activities.
>
> If the movement into insurance dilutes or otherwise overtaxes current management, then it could detract from safety and soundness because management failure is a key element in bank failure.

Concentration is a concern that because banks have access to federal deposit insurance and the discount window, they will undercut agents and subsequently exercise market power.

> There is evidence that banks would capture some of the economic benefits of being low cost (or high visibility) suppliers of insurance.

Coercion is a concern that banks will be able to use their control over other financial transactions to coerce consumers into buying insurance from them.

> Survey evidence does not indicate a great deal of comparison shopping by consumers for financial services. If consumers do not shop around, then the presentation of offers for insurance in conjunction with other financial transactions might be readily accepted either because of the perception of coercion or real coercion.

Point-of-sale service is a concern that bankers will be unable, or unwilling to provide the detailed advice and personal service that the agent does.

It should also be noted that the literature contains evidence on the other side of a number of these issues.

The best available direct evidence suggests that competition between different institutions does operate to lower costs to consumers, and that insurance subsidiaries would be a vehicle to achieve this cost savings.

Banks are already allowed to sell life insurance in the most highly concentrated small markets (those with populations below 5,000), while the larger markets into which they are likely to move are less concentrated.

While the high concentration of banking creates a potential for tie-ins, there is vigorous interinstitutional competition for loans, which appears to be the primary area of concern in the insurance industry.

The survey evidence does not indicate a great potential for tying or the existence of a great deal of tying in those areas where banks currently sell insurance.

With the proliferation of financial advisors, it is hard to accept the argument that somehow insurance agents are uniquely qualified to provide financial advice which incorporates an insurance component.

There is one major caveat to these observations. The benefits documented by cost comparisons and survey evidence are based on only the current set of banks which engage in the sale of insurance. These banks are quite small and there is no guarantee that larger banks, with much greater economic power, would not pose a much larger threat along the lines of concentration and coercion.

POLICY IMPLICATIONS

The uncertainties surrounding bank sale of insurance make it clear that a number of regulatory policies would be necessary to protect bank customers and the banking system, if banks are allowed to sell insurance. It is not certain that a package of such policies can be created and implemented that would simultaneously enable insurance customers to benefit and adequately protect bank customers.

A number of policies to respond to concerns about safety and soundness and concentration are possible.

Separation of the banking from insurance businesses.

Limits on the size of the insurance company relative to the bank.

Restriction of sale of insurance to state-chartered or savings banks.

Possible responses to concerns about coercion include:

a cooling off period after purchase of a bank insurance policy,

the stipulation that an equivalent policy must be acceptable to the lending institution,

preclusion of an offer of insurance prior to conclusion of a transaction which is to be covered by the insurance.

Additional responses to the point-of-sale service and coercion concerns is rigorous disclosure requirements.

Rigorous disclosure would include premiums, death benefits, surrender values, dividends, rates of return, and pure insurance costs, all on an annual basis with the utilization of standardized assumptions to enhance comparability

If banks were willing to meet rigorous disclosure this could be a particularly positive element to inject into the industry.

That there is a serious problem in the pricing and provision of life insurance information is clear on the basis of the literature review and our survey of agents. That savings bank sale of life insurance would help to alleviate the problem also seems clear, but banks are not the cure-all and allowing them to sell life insurance does not come without serious potential problems.

If banks are allowed entry into life insurance, they are likely to specialize in a segment of the market that places a high value on convenience and is extremely price conscious. Although it seems clear that banks would be a low cost supplier, it is also possible that banks would not pass through a large part of the cost savings.

If it could be assumed that savings banks would not engage in cross-subsidy, risk shifting, rent seeking and coercion, then a major benefit could be delivered to consumers. But it cannot

simply be assumed that they would not engage in these behaviors. Quite the contrary is the case. Therefore, regulatory structures and organizational safeguards must be put in place to prevent these abuses. Yet, at some point the safeguards undermine the potential benefits.

Safeguards that require close scrutiny by regulators impose administrative costs and tax the regulatory structures. Current regulation of both the banking and insurance industries leaves a great deal to be desired in its thoroughness and vigor. Asking regulators to oversee the financial transactions between holding companies engaged in banking and insurance to prevent risk shifting and cross-subsidy may be asking too much.

The safeguards that give the greatest protection without relying on regulators, such as separate locations, separate personnel, or preclusion of multiproduct sales may well rob consumers of the convenience and banks of the economies of scope that are the basis for bank sale of insurance in the first place. In the end, the benefits may not be large enough to justify the regulatory costs or risks.

Thank you Mr. Chairman. I appreciate the opportunity to share these views with the committee and look forward to working with you in developing a policy which will help to solve consumer problems in the purchase of life insurance.

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Mr. HUNTER. What I'm saying is you're going to get concentration whether the banks enter or not. You will have more concentration, I believe, if the banks don't enter because what we're seeing now is the concentration toward a handful of major direct writers—State Farm and Nationwide and companies like that. I think bank entry would compete directly with those carriers and will ultimately in the long run mean more companies in the market, not fewer. It might speed the concentration, but it certainly would end up in the long run being a larger universe of underwriters.

One of the problems with insurance is the fact that there is price-fixing allowed and many of these competitors are using the bureau rates which are much above the competitive levels.

The CHAIRMAN. Senator Bond.

Senator BOND. I'd like to follow up now with Dr. Cooper on his studies. You said the research was not conclusive really on these issues and the difference between underwriting and selling insurance—do you have any feel for the difference between those two activities? Do you feel that perhaps—as I gather as Mr. Hunter has indicated—that allowing underwriting would benefit consumers?

DIFFERENCE BETWEEN UNDERWRITING AND SELLING INSURANCE

Mr. COOPER. Well, if you look at the potential economies—and that's what we're looking at—the question is, we have the example of certain State banks, savings banks, selling insurance at the lower cost. The question was, is there an economic basis for that? Is it social policy or is there some real driving economics?

And there are a number of potential ways that banks could achieve economies. For instance, by using their brick and mortar to provide different kinds of transactions you more fully utilize a large capital investment. And that is one of the important bases for potential cost-reducing. That could be achieved through agency and not necessarily underwriting.

To some extent, computerization of sales, the use of mailing lists, could achieve economies, lower costs; and again, that could be achieved through agency and not through underwriting.

Other economies such as streams of profit—that is, it appears that the banking industry and the insurance industry are countercyclical. When profits are high in banking, they tend to be low in insurance and vice-versa. If there's a complementarity there, you may in fact smooth out the rate of profit and that's seen as an economy. It lowers the risk involved in the entity.

That may be more related to underwriting rather than agency. So that there are three or four bases you can observe for potential economies. The one you frequently hear about, this brick and mortar structure, the convenience to the consumer of being able to do one-stop shopping, that's more bound up with agency rather than necessarily underwriting. And at the same time, agency doesn't hold the risk of shifting the risk to the Federal deposit insurance because it should be a separate subsidiary funded by risk capital and there is no access to the discount window or deposit insurance.

So agency has some economic bases for providing benefits at less risk than underwriting, which opens the avenues toward the core of the banking system. There are some econometric studies that sort of lay these things out. In the end, as I say, the potential risk shifting is there—less for agency than for underwriting.

Senator BOND. Well, if the committee were to recommend that banks get into insurance, would you not suggest that there be some type of wall between the assets which are derived from and committed to the strictly banking functions as opposed to any kind of insurance, whether it be agency or underwriting?

Mr. COOPER. Absolutely. There should definitely be a wall and there could probably well be—the evidence suggests that there could be a limit on the relative sizes because most of the studies show that in order to achieve these economies in the portfolio of the holding company you don't need a great big piece of insurance. You could set an upper limit on the amount of insurance business that's done by any bank holding company and that would get the consumer the potential convenience. It would achieve for the banks the potential cost savings without sort of threatening the overall entity.

So there should definitely be a wall and perhaps there should be a limit on the size.

Senator BOND. Now are you referring just to the agency function or do you include the underwriting function when you're talking about the limit and the wall?

Mr. COOPER. I believe that the wall should be for both purposes.

Senator BOND. But would you recommend to us, based on your best estimate and the uncertain research, that there should be provision for banking activities to get into underwriting so long as they are segregated within the holding company and limited, or do you feel that the first step should be only to permit an agency activity?

I know I'm asking you a question that doesn't have a good sound factual basis for answer, but, unfortunately, we may be called upon to make those judgments with less information than you have.

Mr. COOPER. Well, again, if the regulatory package is in place and the mechanisms to implement it and you believe you have a firm handle on those mechanisms, then the distinction I think is less of a concern.

But if the feeling is that the regulations are not going to be in place or could not be fully effective, then one safe step—there are several safe steps. One is to restrict it to agency and to lay on all the other restrictions—for instance, to restrict the size, certainly walling off is a requisite. The other possibility is certainly to allow or encourage States to look at it so that you can provide the convenience.

One of the questions I have been interested in is, how much one-stop shopping could be achieved if only State-chartered banks and savings banks and those kinds of banks got into the insurance business? Could we capture the benefits for consumers of having the one-stop shopping, of having another offerer out there, without opening the potential dangers to the banking system?

My answer would be, if you believe those regulations are there and you can write them into the law, then you don't need to draw

the distinction. If there are concerns about effectiveness of those regulations, there are a couple steps back you can take. One is to do agency only. A second one is to certainly allow the States to go ahead and look at this policy.

Senator BOND. Thank you, Dr. Cooper.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bond.

Thank you, gentlemen, very much for excellent testimony. We are certainly very greatly helped by your insights.

Our next panel will consist of commissioners from the State of Wisconsin and the State of New York. We have Robert Haase, commissioner of insurance, State of Wisconsin; Richard Galecki, commissioner of banking, State of Wisconsin; James Corcoran, superintendent of insurance, State of New York; and Jill Considine, superintendent of banking, State of New York.

We would appreciate it if you could confine your oral testimony to 5 minutes. We will have your written statement printed in full in the record.

Our first witness is Robert Haase, commissioner of insurance, State of Wisconsin.

STATEMENT OF ROBERT D. HAASE, COMMISSIONER OF INSURANCE, STATE OF WISCONSIN

Mr. HAASE. Senator Proxmire and members of the Senate Banking, Housing and Urban Affairs Committee, I am very pleased to be here today. I am the commissioner of insurance for the State of Wisconsin and it just happens to be my second time around, having done this some 20 years ago.

It seems to me that there's a great difference between the way that banks are regulated and the way that insurance is regulated, not only from the fact that to a large extent banking is regulated on the Federal level with a dual system in the States, and from the standpoint of insurance regulation the regulation is almost entirely at the State level.

I am concerned in the regulatory area that if you have a bank-insurance company, if it's one entity as an example, you really have created a nightmare as far as regulation is concerned because with the banking regulation you have the Federal Deposit Insurance Corporation, the Federal Reserve, the Federal Home Loan Bank, Comptroller of the Currency, as well as others, and at the State level you have the State insurance department.

So that this could really present some very serious problems when it comes to regulation.

SERIOUS REGULATORY PROBLEMS

For example, back 20 years ago in Wisconsin we created the first guaranty fund and now they have them all over the United States, in most of the States in many areas. What happens if you have a bank-insurance company that does become insolvent? Is the FDIC going to pay for the insurance claims? Are the guaranty funds going to pay for the losses in the bank?

It seems to me, in addition to that, who is going to handle this regulatory problem? Is it going to be the Federal Government or is it going to be the State government?

We have seen that even where you have a separate entity such as the bank holding company approach, but in the Baldwin-United situation that occurred very recently, we have seen that even if they are separate, if one goes down they both go down. Suddenly you have a problem that you hadn't expected to have at all.

So that it seems to me that from the regulatory standpoint, it's a very difficult situation. I've heard people talking this morning about if you can have the right regulatory situation then we can do this and we can do that. But I haven't heard anybody say what that regulatory system is.

It would seem to me that if you are actually going to allow banks to be insurance companies and underwrite insurance, then you have to regulate this really from the Federal level because it just can't be done on a dual basis in my opinion. Yet, if you attempt to do that, then it seems to me that you are disrupting what I consider to be a very efficient and well operated State regulatory system in the insurance field right now.

So that I find problems if it's a single organization and I still find problems even if there is this wall because you can't keep the wall from tumbling down and have them both going into insolvency together.

When it comes to competition, it seems to me that you do have a form of reverse competition, whether it is intentional or unintentional—tie-in sales and so forth—because of the fact that when a person goes to a bank and they want to make a loan, as has been said earlier and has been mentioned by Senator Proxmire, they expect that they have to buy whatever kind of insurance it is in order to get the loan. You notice when you apply for a credit card, it says, do you want to have credit life? I think a lot of people automatically mark "x" to make sure they're going to get the credit card. It isn't necessarily that they need it, but they think that's one way to get it.

And this is not a new problem. There is reverse competition. Back in 1965, the first thing I did as insurance commissioner was held a hearing and reduced the rate in Wisconsin from $1 to 75 cents. Then we later lowered it to 60 cents. Now it's down to 40 cents. This was done entirely by regulation. It isn't because circumstances have changed or anything else. It's simply that we have recognized that reverse competition does not work in the interest of the consumer and continually chop away at it trying to get it down to something reasonable.

So that there is reverse competition. It not only exists there. It exists in—I'm sure you're quite aware—in such things as title insurance and mortgage guarantee insurance. The bank has a tremendous advantage. If you have to go to the bank to buy a house, why wouldn't the bank not sell you home owners policy and you think you have to buy. So that in the end, it seems to me that, from a regulatory standpoint, it's not going to be very easy if it can be handled at all. From the standpoint of competition, it's going to reduce rather than increase competition.

Last, I am very concerned with this concentration in wealth in the power of a very limited few. Supposing that Prudential decided to hook up with Citibank, for example. If that kind of a monolith occurred and it got into financial difficulty, it would have great effect I think on our entire monetary system. And I don't think that people who deposit their funds in a bank should be having to worry about the fact that perhaps you have a bad year in the insurance field and they will lose everything that they invested.

The problem I see with all this is today the FDIC does take care of bank losses. Insurance guaranty funds at the State level have been able to take care of insurance losses, but what happens when you combine the two? When you have the tremendous losses, are they going to be able to withstand that?

So in the end I have difficulty in determining how either consumers of banking institutions or consumers of insurance institutions are better served or better off by allowing the two to merge. In the end, I only see more problems and less competition.

Finally, let me say that if this is being done in the guise of deregulation, those who support this approach are totally wrong. Insurance and banking, in my opinion, are areas where there has to be regulation. In my opinion, in these areas deregulation is a buzz word which we would all be better off without.

Thank you.

[The complete prepared statement of Robert D. Haase follows:]

The CHAIRMAN. Thank you, Mr. Haase, for an excellent statement. We very much appreciate it.

Commissioner Galecki, go right ahead, sir.

STATEMENT OF RICHARD E. GALECKI, COMMISSIONER OF BANKING, STATE OF WISCONSIN

Mr. GALECKI. Thank you, Senator Proxmire. Greetings from the State of Wisconsin. I don't know if I should continue to sit next to Commissioner Haase after I've heard his statement.

The CHAIRMAN. Well, I'll tell you, that was about as good a Republican statement as I've ever heard. It almost sounded like a Democrat.

Mr. HAASE. I was going to say, it doesn't go along with what my President thinks, however.

The CHAIRMAN. That's right. That's why I thought it was so good. [Laughter.]

Mr. HAASE. Well, I've been around too long to worry about that, Senator.

Mr. GALECKI. Our office, in addition to regulating the banks, regulate the finance companies, et cetera, and you've heard a lot about regulation today and I'd like to just bring two cases to light.

EXAMPLES OF ABUSE

In 1984, we found a major finance company that was packing or loading insurance to the tune of we felt about $12.5 million, and we had them file a stipulation, a consent judgment, in court, paid a forfeiture of $100,000 to the State of Wisconsin, and to date have refunded over $5 million to consumers. That also represented about 70,000 cases.

In 1986, we found a savings and loan that was requiring customers to purchase certain default insurance on mobile home purchases. We found that they were not disclosing it on their consumer reports and were not making rebates properly. That savings and loan also stipulated to a judgment, refunded over $100,000 and paid a $5,000 fine.

We find other cases when we do our examinations and in most cases the financial institution will make restitution immediately, send us copies of the consumer letters, and if we do find a flagrant violation, we require them to go back a number of years and when we come back in we review that situation.

Since 1975, the State of Wisconsin has allowed banks and their subsidiaries to offer insurance. From an informal survey that we did, we found that 50 percent of the banks sell only credit life and disability insurance. Another 43 percent sell a full line of insurance products along with credit life and disability, and 7 percent of the banks do not offer any type of insurance.

We have also found that the banks are not registered with the commissioner of insurance, but the necessary officers and/or employees all carry insurance licenses.

Our department has regulated the banks and told them how they can offer the insurance and how they can pay the commissions to their employees. We have not found violations in this type of situation.

The fact is that States operate as laboratories for change. The ability of States to charter banking corporations carries with it the duties to determine an appropriate scope of activity. Such responsibilities have resulted in important public benefit and has led banks to engage in controlled experiments and has often resulted in subsequent action by Congress authorizing similar functions.

In 1986, we also passed our interstate bill and I'd like to bring up two points that were passed by the State of Wisconsin.

No. 1, with the approval of my office, banks can invest up to 10 percent of capital and surplus in other businesses and there is no limitation on the type of businesses they can invest in.

No. 2, again with the approval of our office, they can have subsidiaries that take on other functions and can exercise any power of other financially related product or service in Wisconsin.

To date, we have had the State legislature approve through rule making that banks can offer real estate brokerage, not land development or real estate investment. We have also had some discussions with travel agencies. To date, that has not been approved but is still going into expansion.

We have many consumer laws in the State of Wisconsin, as I'm sure you're aware of. We also have a tie-in provision that requires all financial institutions to disclose to customers any subsidiaries that they now own and that the customer is not required to do business with those subsidiaries to do the specific service they are requesting. To date, we have had no consumer complaints regarding this issue.

Wisconsin has always been a very strong consumer act State and insurance has not been a problem in the marketplace. Wisconsin is also a very significant agricultural State. Our office regulates 450 banks which are rated under the CAMEL rating or the uniform bank rating, with 1 being the best and 5 being the worst.

In the last year, our 1 and 2 rated banks have increased from less than 76 percent to over 78 percent; and our worst rated banks of 4 and 5 have decreased from 5.6 percent to 4 percent. I think the banking industry as a whole is trying to recognize their problems and are making efforts to resolve these various problems.

Our ratios of banks' capital, loan-to-deposit ratio, loan loss reserves and earnings have been very good. I believe that the capital ratios will continue to be good, but I believe earnings will continue to decrease.

From a recent meeting at the 7th Federal Reserve District in Chicago, we found that banks are using more and more of their bond profits to keep their profits at a level or increase in the previous year's earnings. From our recent examinations, we have found that in many cases now the bond portfolios are in such case that the market value is less than the book value.

I feel that we must continue to allow banks to experiment with new services as long as we can regulate them so we do not find them stretching their loan policies and other things to increase their earnings. The spreads between loans and deposits continue to decrease and competition continues to take a larger portion of what was bank business. Other comparable services, such as insurance, must be offered to keep the industry strong and successful over the years. And I can assure you we can regulate them.

[The complete prepared statement of Richard E. Galecki follows:]

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The State of Wisconsin
Office of the Commissioner of Insurance

OCI

Robert D. Haase
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Testimony before the United States Senate Committee
on Banking, Housing, and Urban Affairs
By Wisconsin Commissioner of Insurance, Robert D. Haase
on July 29, 1987

Senator Proxmire and members of the Senate Banking Committee, my name is Robert Haase. I am the Commissioner of Insurance for the State of Wisconsin. I might add that this is my second time around in this position having been the commissioner in Wisconsin some twenty years ago. I appreciate the opportunity to express my views concerning the regulatory issues involved with the entry of banks into the insurance field or insurance companies into the banking field, as well as the many concerns I have involving the protection of consumers; in particular

- the problems which would affect our present state and federal regulatory systems,
- the problems created for the insurance guaranty funds,
- the effects this would have on competition in the fields of insurance and banking, and
- the impact this would have on the consumer.

1. Regulatory Considerations

As you well know, insurance is regulated primarily by the states, with its purpose to ensure that insurance is available to those who need protection at a fair and reasonable rate issued by a company that is financially sound. I can think of no greater consumer complaint than one which says, "I filed my legitimate claim with my company only to find that it has become insolvent and no longer affords protection." To further protect consumers from this problem of insolvency, the State of Wisconsin passed the first guaranty fund in 1969 which have been adopted in one form or another by most of the states.

Banks, on the other hand, are primarily regulated by the federal government although they fall under a dual-regulation system with state governments. As I perceive it, banks are largely regulated to, as nearly as possible, ensure risk-free protection of deposits, while at the same time making capital available for economic growth.

It is clear to me that these entities operate in entirely different spheres. Insurance is based upon risk and it is the thrust of insurance regulators to seek to ensure that this risk is handled in such a way as to minimize insolvency. This is accomplished through very conservative reserve and surplus requirements as well as the guaranty funds in the event insolvency does occur.

Solvency is also the hallmark of banking regulation. However, the thrust here is to eliminate risk. It was, perhaps, for this very reason that banking and commerce has always been separated. Banks are not allowed to invest in equity securities of a commercial enterprise. Banks are restricted from an affiliation with a parent company that engages in commerce directly or indirectly. These concerns are well known to you, I am sure and I need not go into them here. But, it appears clear to me that a bank which is also an insurance company would be engaging in risks far beyond the concerns stated above.

To fulfill their unique role as sources of liquidity and credit, banks must have ready access to many sources in addition to deposits. This is quite a different situation than an insurance company operates within.

From the standpoint of regulation enabling banks and insurance companies to operate as one entity creates a real nightmare. Banks are regulated largely by the federal government involving the Federal Deposit Insurance Corporation, the Federal Reserve, the Federal Home Loan Bank Board, the Comptroller of Currency as well as others. For a number of reasons, including differing accounting procedures, reserve requirements and overall approach to business, the banking and insurance industries are very different. Regulatory techniques and requirements are quite different. It would seem that the only solution would be to create a bureaucracy of monstrous proportions at the federal level which, in my opinion, would create more serious problems while really solving none. In addition, it would completely disrupt what I believe to be an efficient, well-functioning state insurance regulatory system, whatever the faults which from time-to-time are attributed to it. However, there is another problem in regulation which should not under any circumstances be allowed to continue or blossom. This is the so-called state law loophole. As you know, South Dakota has passed a bill allowing state chartered banks to become insurance companies in South Dakota. However, the law allows such bank-insurance companies to offer their insurance products and services only outside the State of South Dakota. This should not be confused with the authority of states to regulate their state chartered banks, because it obviously was not intended as an internal regulatory control, but merely a blatant attempt on the part of South Dakota to get large banks to bring their insurance and banking operation to South Dakota. In passing such a law they have shown no concern for its impact on other states or on the national banking system. Pressure is sure to build in other states if the moratorium is lifted. This must be prevented for all of the reasons stated above. Public policy with respect to the expansion of powers of bank holding companies and federally chartered banks and other thrift institutions should reside only with the federal Congress.

2. Guaranty Fund Problems.

Think for a moment as to what will happen if a bank-insurance company becomes insolvent. Would the losses be covered by the Federal Insurance Deposit Corporation? Would the losses be covered by the state guaranty funds? How do you separate out the bank's losses made on poor loans from the claims made by policyholders? What agency would handle the liquidation if it became necessary?

If, as stated above, it would be necessary for a federal agency to handle this matter, is the federal government ready to assume this additional financial burden at a time when bank failures are very high and insurance company failures are also occurring at an alarming rate?

Should bank depositors risk losing their wealth because of high losses in the insurance field? Should insurance claimants lose their rightful claims because some foreign nation is unable to repay a multi-billion dollar loan?

3. Effects on Competition.

Because banks are the principal providers of credit, consumers have a perception that the bank is in a superior bargaining position in a loan transaction. This leads to a potential abuse of a bank's power to grant the loan by tying the transaction to a sale of insurance. Credit life and disability insurance are areas where we are all aware that this power exists and has led insurance regulators to set maximum premium rates that can be charged for this type of policy. They also require that the lending institution make it clear to the borrower that they do not need to purchase credit life and/or disability insurance and if they choose to purchase it, they do not need to purchase it from the agent at the bank. But, there are less explicit tie-ins which are very difficult to detect which are just as damaging. What small borrower is going to be able to ignore the subtle pressures to purchase insurance when they believe that they had better buy it to motivate the lender to grant them the loan?

This then results in reverse competition. It simply means that since the lender is an agent selling the credit insurance, the higher the rate, the greater the commission. I am sure you have heard much about this, not only in credit insurance, but also in title insurance and mortgage guaranty insurance. Such a situation will inevitably lead to higher premium rates and regulatory problems. If you doubt that "reverse competition" is a real problem, in my own experience as Commissioner of Insurance in Wisconsin, I have seen rates for Credit Life insurance go from $1.00 per one hundred dollars of loan to forty cents per hundred because of the action of the insurance department.

Contrary to the belief of some, it is my opinion that no dearth of competition exists in the insurance industry as is evidenced by the fact that there are over 5,000 insurance companies in the United States. It is my belief, however, that creating bank-insurance companies will lessen competition.

To arrive at this conclusion one has to ask, "Why do banks want to become insurance companies?" I believe it is safe to assume that the banks are looking at this field to enable them to be able to invest in areas which they are not now allowed and, of course, with an eye toward turning a profit. And they feel they can have a greater profit by being the insurance company than just investing in it.

But, this will, in my opinion, result in many of the smaller insurers who have offered full lines of insurance finding themselves not being able to compete and they will be eliminated, either by terminating their business or, more likely through acquisition, in much the same manner as we are seeing the

demise of the small independent bank today. And, while I am on that subject, the demise of the small banks will accelerate as they will be unable to compete with the underwriting capabilities and services offered by the large bank-insurance conglomerates.

In addition, if the bank-insurance financial institution decides, and well it might, to write only the more profitable lines such as homeowner's insurance in connection with a home mortgage, it will leave the insurance agents with the less profitable business, again resulting in a lessening of competition.

4. The Consumer.

Consumers believe that banks are safe. Consumers believe that their money is protected by the Federal Deposit Insurance Corporation. Isn't it logical to assume that consumers will believe the same to be true of any transaction within the bank, including the purchase of insurance? Thus, as banks expand their sales into more and more areas, including regular life insurance and personal lines, they will command a greater share of the market which will lead to greater concentration rather than more competition as traditional insurance companies, not affiliated with deposit-taking banks, are unable to compete. This problem is only amplified by the bank-insurance company.

I am further concerned by the great concentration of wealth and, therefore, power in the hands of a limited number of bank-insurance companies, for several reasons.

First: If such a financial monolith gets into financial trouble, it would tend to destabilize our entire monetary system.

Second: I believe it is dangerous to the consumer to have their deposits, their investments and their insurance protection all housed in and controlled by the same entity for all of the reasons stated above. Consumers simply will not be able to separate them out and will likely deal with the bank because they will perceive it to be in their best interests.

Third: Insurance consumers as well as bank depositors have a reason to believe today that they are well protected by the FDIC and insurance guaranty funds. Will the same be true if the two institutions are melded into one?

5. Conclusion.

In the end, I have difficulty in determining how either consumers of banking institutions or consumers of insurance institutions are better served or better off by allowing the two to merge. In the end I only see more problems, less competition and nothing gained.

Perhaps, if it must be that somehow banks and insurance companies must be allowed to wed, it might work if they are kept a separate corporate entity and if they can be properly regulated, but I must conclude that the risks involved will make the American public the ultimate loser.

Lastly, let me say that if this is being done in the guise of de-regulation those who support this approach are totally wrong. Insurance and banking are areas where regulation is a must, if we are to protect consumers. In my opinion, in these areas "de-regulation" is a buzz word which we would all be better off without.

The CHAIRMAN. Thank you, Mr. Galecki.
Superintendent Considine, go right ahead.

STATEMENT OF JILL M. CONSIDINE, NEW YORK STATE SUPERINTENDENT OF BANKS

Ms. CONSIDINE. Thank you, Mr. Chairman and members of the committee, for the opportunity to appear this morning.

Before I proceed with my comments, I would respectfully request that I be permitted to submit a written testimony at a later date.

The CHAIRMAN. Without objection, your statement will be printed in full in the record.

Ms. CONSIDINE. Let me set the stage on New York's regulatory capability.

I presently supervise over 35 percent of all State-chartered banking assets in the United States with banks ranging in size from $3 million to $70 billion. The department also has supervisory responsibility over 17 types of financial institutions, including commercial banks, thrifts, credit unions, foreign bank entities, mortgage bankers and brokers, small loan companies and check cashers, totaling $1 trillion in assets.

This is accomplished with a staff of 500.

The CHAIRMAN. You said from $3 million to $70 billion?

Ms. CONSIDINE. Yes. This is accomplished with a staff of 500, having an average experience of 15 years as examiners.

Your invitation today requested testimony on the regulatory issues of bank entry into insurance and the safeguards necessary for consumer protection and safety and soundness. I would like to relate the history of our experience in New York State, our plans for the future and the safeguards which we feel are necessary.

NEW YORK STATE EXPERIENCE

The extent and history of existing insurance activities conducted by banks may not be fully appreciated. And if it were, it might not appear so radical. Since 1864, national banks have been authorized to sell insurance products in communities of less than 5,000 population and credit life insurance has long been a permissible banking activity. Currently, 16 States permit some form of insurance. Moreover, Congress in 1982 codified several exceptions to the prohibition on banks engaging in insurance and activities of some bank holding companies have long been grandfathered. Additionally, many of our multinational banks participate actively in the insurance markets abroad.

In the Northeast States of New York, Massachusetts, and Connecticut, banks have long been offering savings banks life insurance. Since 1938, savings banks have been selling that product to those who live or work in New York State. Currently, there are more than a ½ million policies outstanding totaling over $12 billion. That represents approximately 3 percent of the New York life insurance markets. The success of SBLI in New York, I believe, is testimony to the attractiveness of the product in terms of cost and convenience and also the quality of the supervisory environment.

In the almost 50-year period of its existence, our experience with savings banks life insurance has been excellent. The New York

State Banking Department shares supervisory responsibility with the New York State Insurance Department. This relationship could serve as a model for future functional regulation. The two departments alternate on-site examinations and emphasize different aspects of the institution's insurance activities. Although both supervisors are interested in the insurance operation, the banking department examination concentrates on investment asset quality and earnings while the insurance department emphasizes actuarial considerations and compliance with insurance regulations.

As you are probably aware, a temporary State commission on banking, insurance and financial services, the so-called DeWind Commission, was appointed by Governor Cuomo. The purpose of the commission was to study the financial services industry in New York and to recommend a legal and regulatory framework to foster the orderly development of the financial markets.

Our current thinking, which is consistent with those major recommendations, envisions the gradual entry of banking into insurance, starting first with agency and brokerage, leading eventually to life insurance underwriting and ultimately into property and casualty underwriting. We also propose comprehensive safeguards to protect the consumer and to prevent possible coercive abuses in the sale of insurance services by banks. Included are requirements for dual supervision by the banking and insurance departments, professional standards for bank insurance agents, disclosure requirements, a prohibition against discussion of insurance by a bank or its agent until after the loan application has been acted upon in writing, as well as a 30-day cooling off period, during which time the policy can be canceled without undue penalty.

I have given you some background on where we are and where we would like to be. But for me as a regulator and you as the premier legislative body in the land, what are the major safety and soundness considerations in terms of protecting the bank from difficulties in nonbank areas and how can we provide an optimum regulatory framework to supervise these diverse activities?

Well, organizational structure can be an important component in insulating one affiliate from the consequences of financial difficulties in another. We believe that in a hierarchy of options ranging upward from bank departments through bank affiliates and holding company subsidiaries, the latter provides the best legal avenue for insulation of insurance underwriting activities. The New York legislation envisions separate banking and insurance subsidiaries and mandates functional regulation of the separate lines of business.

A combination of competent functional regulation, sufficient capitalization, and gradual entry into insurance activities, with an emphasis on first developing organizational expertise to handle these ventures, will provide reasonable assurance that bank entry into insurance can be accomplished in a safe and sound manner.

Finally, I believe the addition of insurance products will add to the overall safety and soundness of the banking system by providing banking organizations with expanded market opportunities to diversify sources of income and risks.

I would like to thank the committee for inviting me to comment on this matter which has implications far beyond the mere delivery

of insurance products to the public. As we have seen in the context of regional interstate bank expansion, the State and Federal agencies have demonstrated the capacity to develop a coordinated regulatory environment. If the Congress were to legislate integration of banking and insurance, the existing regulatory framework has the flexibility to permit implementation of the Federal policy through individual State initiatives.

In this, the bicentennial year of the Constitution, it seems appropriate to remember that the doctrine of States' rights in our system both serves community needs and provides new ideas which can be implemented at the national level. I find this especially true in the area of banking regulation. In New York State we have been at the forefront in instituting policies that have had national influence. Among our initiatives have been reciprocal interstate banking in 1982, funds availability in 1984, and truth in savings in 1978.

I am pleased that hearings such as these will continue to be held during the study period, but I am rather disappointed the moratorium is contemplated because I think it may have a chilling effect on the activities at the State level which can serve as a test bed in proving what can be done.

Thank you for your attention.

[Complete prepared statement of Jill M. Considine follows:]

BANKS AND INSURANCE

Oral Testimony

by

Jill M. Considine

New York State Superintendent of Banks

before the

United States Senate Committee

on

Banking, Housing, and Urban Affairs

July 29, 1987

Washington, DC

REMARKS OF RICHARD E. GALECKI

COMMISSIONER OF BANKING OF THE STATE OF WISCONSIN

July 29, 1987

It is a pleasure appearing before this committee to discuss further insurance possibilities for banking.

I also bring you greetings from the State of Wisconsin.

In the way of background, my office regulates banks, loan companies, collection agencies, sellers of checks, insurance premium finance companies, motor vehicle finance companies, community currency exchanges, adjustment service companies and also handles consumer complaints.

Over the years, we have had few complaints regarding the packing/loading of insurance by banks. In 1984, our office, along with the Department of Justice, brought an action against a nationwide loan company for allegeo loading of insurance which involved 70,000 consumer policies. A stipulation and consent judgement was entered and a forfeiture of $100,000 was assessed. It was estimated the total refunds to consumers could amount to $12,500,000 and to date over $5,000,000 has been refunded.

In 1986, a savings and loan allegedly required customers to purchase insurance protecting the consumer against risks related to a customer's default on a mobile home purchase without incorporating the premium into the finance charge in violation of the Wisconsin Consumer Act. It was also alleged that the savings and loan did not rebate a portion of the finance charge. Our office, along with the Department of Justice obtained a consent judgement requiring more than $100,000 in refunds to mobile home customers as well as a forfeiture of $5,000.

Other than these two cases, the majority of complaints or questions about insurance have been handled in a very equitable manner by all financial institutions.

If, during our examinations, we find violations, they are normally corrected immediately and we receive copies of correspondence to the consumers. If we find a flagrant violation, we require the company to go back a number of years and again make the necessary adjustments.

Since 1975, banks have been able to offer insurance services in Wisconsin and from that time forward, they have opened subsidiaries, and have sold insurance directly. From a informal survey of the banks, we have found that 50% of the banks sell credit life and disability insurance with an additional 43% selling a full line of insurance products, along with credit life and disability. The balance of 7% do not offer insurance services to their consumers. In most cases, the banks are not licensed with the Office of Commissioner of Insurance but in all banks that offer

insurance the bank officers or a number of bank employees are licensed with the Office of Commissioner of Insurance.

Over the years, some questions arose as to the tie-in of bank officers selling insurance and also making the loan. I am enclosing copies of two interpretative letters. The first letter being Banking Letter #7 dated May 12, 1969 and the second being Banking Letter #38 dated November 28, 1983. These letters were issued so banks knew how insurance could be sold and commissions could be paid to their employees. We are presently reviewing these letters as more banks desire entry into a full service insurance agency relationship and, therefore, want to compensate their insurance employees strictly on a commission basis as opposed to a salary and bonus basis.

The fact is that the states operate as laboratories for change. The ability of states to charter banking corporations carries with it the duty to detrmine an appropriate scope of activities. Such responsibility has resulted in important public benefits, has led banks to engage in controlled experimentation and has often resulted in subsequent action by Congress authorizing similar functions.

In 1986, a regional interstate banking law was passed by the Wisconsin Legislature (a copy of that law is attached). In addition to the interstate provisions, the new law gave banks expanded powers.

I would like to elaborate on two of these powers:

1. Banks, with the approval of the Commissioner of Banking, could invest up to 10% of capital and surplus in any company, such as mortgage, title companies, etc. This provision was really established as an economic development initiative.

2. Banks would, subject to approval by the Office of Commissioner of Banking, be able directly or through a subsidiary to undertake any activity, exercise any power or offer any financially related product or service in Wisconsin that any other provider of financial products or services could undertake or that the Commissioner found to be financially related.

To date, I have approved and have had approved by the state legislature through rule making, that banks may offer real estate brokerage services but not land development and real estate investments (a copy of the rule is attached). Since the approval, we have had three banks apply for the service. If we find no problems, we would consider permitting expansion of these powers in future years.

My office also proposed a rule offering travel agency services as an additional banking service, but because of various requirements, this rule has not been approved by the Legislature.

Along with the expanded powers came new consumer protections. Wisconsin, with its strong history of consumer advocacy incorporated into the interstate banking law, a tie-in provision (a copy of the Statute is attached). The law requires that in a transaction conducted by a bank,

bank holding company, or subsidiary of either with a customer who is also a customer of any other subsidiary of them that the customer be provided notice of all other organizational relationships of the entity the customer is dealing with. Furthermore, the customer must be informed that he or she need not purchase other products or services from any of the related companies in order to participate in the intended transaction. To date, we have had no consumer complaints regarding this issue.

Consumers are provided other protections with respect to the sale of various consumer related insurance products by the Wisconsin Consumer Act, a body of law setting forth strict disclosure, notice, cancellation and refund requirements. We feel we have and can continue to effectively regulate the sale of any insurance services while at the same time permitting banks to compete in the market place.

All of you on the committee are aware that Wisconsin is a significant agricultural state. At present, my office regulates 450 state chartered banks. Banks are rated using the Uniform Bank Rating System which is also known as the CAMEL rating, which stands for capital, asset quality, management, earnings and liquidity. The rating goes from 1 to 5, 1 being the highest and 5 being the lowest. In the last year, our 1 and 2 rated banks have gone from a less than 76% ratio to over 78% ratio and our 4 and 5 rated banks from 5.6% to a 4%. The banks as a whole have operated well in this most trying time and have recognized their problems and have made efforts to resolve their various problems.

The total assets of the state chartered banks as of March 1, 1987 was $23.5 billion, the capital to deposit ratio was approximately 9.7% which is very high and the loan to asset ratio was approximately 55%. The loan loss reserve was approximately 1.25%, the net income to total capital approximately 12% with net income to assets of approximately 1%. I believe the capital ratio will continue to be strong, but the earnings ratio will decrease.

In the past thirteen years, Wisconsin has experienced only two bank closings, one in June, 1985. The chairman and president are presently serving time in prison. With respect to the second closing, in June, 1986, final legal action is still pending.

Banks in Wisconsin have always rated high in the 7th Reserve District and in the United States. From a recent meeting at the Federal Reserve Board in Chicago, an analysis was made of banks in the 7th Reserve District showing more and more banks taking bond profits to keep their earnings level or ahead of the previous year, and we are now finding that in bond portfolios, market value is less than the book value. It is, therefore, necessary for banks to find expanded powers and services to augment their earnings. If profits cannot be found and new services offered, banks may stretch loan policies for additional earnings.

The spreads between loans and deposits continue to decrease and competition continues to take a larger portion of what was bank business. Other compatible services, such as insurance, must be offered to keep the industry strong and successful over the years.

Thank you for your invitation to speak before your committee. I would be happy to answer any questions.

Credit Life Insurance #7

The following resolution pertaining to the sale of credit life, health and accident insurance sold by banks in connection with loans was adopted by the Banking Review Board in meeting May 9, 1969, as a department directive:

Credit Life, Health and Accident Insurance sold in connection with loans is directly related to the business of banking. In order to eliminate the possibility of a conflict of interest the commissions on the sale of such insurance must be paid to the bank.

The sale of other forms of insurance or brokerage of real estate by an officer or employe of a state bank may be carried on only after authorization of the Board of Directors, duly recorded in the minutes of the meeting of the Board of Directors.

Directors may require the officer to submit such records of income producing activity as they deem necessary.

Bkg. Ltr. #7, May 12, 1969, Commissioner Heinzelmann

Insurance Services of Wisconsin Banks #38

Historically, Wisconsin banks have offered a number of insurance services and in recent years they have begun to offer an increasing variety of these services. Insurance services include the solicitation, negotiation or placement of any line of insurance or annuities on behalf of an insurer or on behalf of a person seeking insurance or annuities, as well as advising other persons about their insurance needs or coverage. This Interpretive Letter contains general guidance as well as specific procedures to be followed by Wisconsin state chartered banks offering or proposing to offer insurance and related services. It also discusses certain attendant supervisory concerns and legal issues. This letter applies to any sale of insurance at a bank or branch office.

Traditionally, commercial banks in Wisconsin have sold various forms of life insurance, property insurance, unemployment insurance and mortgage guarantee insurance in connection with both commercial and consumer loans. Moreover, banks and employees of banks are expressly authorized to be licensed by the Commissioner of Insurance as insurance intermediaries and to offer a full range of insurance services to the general public. (Section 221.04 (9), Wis. Stats.) Each bank, bank subsidiary or bank employee who provides insurance services must observe the applicable licensing requirements of the Office of the Commissioner of Insurance and comply with applicable insurance laws and rules.

A bank may provide insurance services at its home office, authorized branch offices, and other locations, provided the bank does not make loans, accept deposits, provide trust services other than as permitted by sec. 221.04 (6), Wis. Stats., or cash checks or other negotiable instruments at such other locations. A bank may organize or acquire a corporate subsidiary for the purpose of providing insurance services if it first obtains written approval of the Commissioner of Banking and otherwise complies with Bkg. 3.04.

In order to avoid any possible conflict of interest, any commissions earned on the sale of insurance by any officer or employee of a bank must be paid directly to the bank. (See also Bkg. Ltr. #7, 5/12/69.) A bank may, however, institute a bonus or incentive program under which employees receive payments based upon their sale of insurance products provided the payments are not made more frequently than quarterly and the amount received by any employee during one year does not exceed 5% of the recipient's annual salary or 5% of the average salary of all loan officers participating in the incentive program, whichever is greater. (See e.g., 12 C.F.R., sec. 2.4, for similar standard for national banks.) Employees of insurance subsidiaries of a bank may be compensated on a commission basis.

Except with respect to insurance which insures a bank against loss in connection with a particular loan, and mortgage or title issurance, no officer or employee of a bank who personally approves a borrower's applications with respect to a particular loan may sell any insurance to the borrower at the time a loan is made. The time a loan is made includes any time from the date of the loan application to the date of the loan closing.

The Wisconsin Consumer Act, Chs. 421-417, Stats., requires certain disclosures by creditors who sell insurance which is financed as part of a consumer credit transaction. It also limits the types of insurance which may be sold in connection with such a transaction and the premiums which may be excluded from the finance charge. (See Sec. 422.202, Wis. Stats.; Bkg. 80.26; and Official Interpretation #4.) This letter is not intended to alter those disclosure requirements or to modify those limitations.

While a bank may be licensed as an insurance intermediary, and offer insurance services, this letter may not be construed to imply that a bank may underwrite insurance policies or invest in any corporation which underwrites or issues any type of insurance policies.

Bkg. Ltr. #38, November 28, 1983, Commissioner Dixon

(2) (a) Except as otherwise provided in this subsection, the total liabilities of any municipal corporation to any bank for money borrowed shall at no time exceed 25 per cent of the capital and surplus of such bank.

(b) Where such liabilities are in the form of bonds, notes or other evidences of indebtedness which are a general obligation of any city, town, village, county, vocational, technical and adult education district or school district in this state the total liability of any such municipality shall at no time exceed 50% of the capital and surplus of such bank. The total amount of temporary borrowings of any such municipality maturing within one year from date of issue shall not exceed 60% of the capital and surplus of such bank. Temporary borrowings and longer term Wisconsin general obligation borrowings of a single municipal corporation may be considered separately in arriving at the limitations provided in this subdivision.

(c) Liabilities in the form of revenue obligations of any municipality of this state are subject to the limitations provided in sub. (2) (a) but in addition thereto any bank is permitted to invest in any general obligation of such municipality an amount which will bring the combined total of such general obligations and such revenue obligations of a single municipality to a sum not in excess of 50 per cent of the capital and surplus of such bank.

(3) The discounting of bills of exchange drawn in good faith against actually existing values and the discounting of commercial or business paper actually owned by the person negotiating the same shall not be considered as money borrowed within the meaning of subs. (1) and (2).

(4) No bank may make or renew any loan or loans, the aggregate total of which exceeds the level established by the board of directors without being supported by a sworn financial statement unless the loan is secured by collateral having a value in excess of the amount of the loan.

(5) A sworn financial statement furnished by the borrower to a bank in compliance with sub. (5) must be renewed annually as long as the loan or any renewal thereof remains unpaid and is subject to sub. (5).

(7) A loan or a renewal of a loan made by any bank in compliance with sub. (5), without sworn financial statement, may be treated by such bank as entirely independent of any secured loan made by the same borrower providing such loan does not exceed the loan limitations provided in this section.

History: 1971 c. 40, 154; 1973 c. 114, 1979 c. 304, 1979 c. 308, 335, 1983 a. 125.

221.306 Other loans and investments. (1) Except as provided in sub. (3), a bank may lend under this subsection, through the bank or a subsidiary of the bank, to all borrowers from the bank and all of its subsidiaries, an aggregate amount not to exceed the percentage of its capital and surplus established by the commissioner under sub. (3). Neither a bank nor any subsidiary of the bank may lend to any borrower, under this subsection and any other law or rule, an amount that would result in an aggregate amount for all loans to that borrower that exceeds the percentage of the bank's capital and surplus established under sub. (3). A bank or its subsidiary may take an equity position or other form of interest as security in a project funded through such loans. Every transaction by a bank or its subsidiary under this subsection shall require prior approval by the board of directors of the bank or its subsidiary, respectively. Such loans are not subject to s. 221.36 or to classification as losses for a period of 2 years from the date of each loan except as provided in sub. (3).

(2) Except as provided in sub. (3), a bank may invest under this subsection amounts not to exceed, in the aggregate, that percentage of its capital and surplus established by the commissioner of banking under sub. (3) in equity positions, such as profit-participation projects. A bank may take an investment position in a project with respect to which it is also a lender. The bank shall limit its liability as an investor in a specific project under this subsection to an amount not exceeding the amount of its investment in that project. For purposes of calculating the bank's aggregate investment under this subsection, the amount of each investment shall be established as of the date that the investment is made. Every transaction by a bank under this subsection shall require prior approval by the board of directors of the bank and shall be disclosed to the shareholders of the bank prior to each annual meeting of the shareholders.

(3) The commissioner of banking shall establish for each bank the applicable percentage, not to exceed 20%, under sub. (1) and the applicable percentage, not to exceed 10%, under sub. (2). The commissioner may withdraw or suspend a percentage established under this subsection and, in such case, may specify how outstanding loans or investments shall be treated by the bank or subsidiary. Among the factors that the commissioner may consider in establishing, withdrawing or suspending a percentage under this subsection are the bank's capital, assets, management and liquidity ratio and its capital ratio.

(4) At the time of making a loan or investment, the bank or subsidiary shall note in its records whether it is made under sub. (1) or (2). The forms of security for loans under sub. (1) and the forms of investment under sub. (2) shall be as approved by the commissioner of banking by rule.

(5) This section does not authorize a bank, directly or through a subsidiary, to engage in the business of underwriting insurance.

History: 1985 a. 325.

221.306 Other investments; farm operations. (1) A bank may invest amounts not to exceed, in the aggregate, that percentage of its capital and surplus established by the commissioner of banking under sub. (2) in partnership interests in farm operations. A bank may acquire a partnership interest in a farm operation with respect to which it is also a lender. The bank may only acquire a partnership interest in a farm operation as a limited partner. For purposes of calculating the bank's aggregate investment, the amount of each investment shall be established as of the date that the investment is made. Every transaction by a bank under this subsection shall require prior approval by the board of directors of the bank and shall be disclosed to the shareholders of the bank prior to each annual meeting of the shareholder.

(2) The commissioner of banking shall establish for each bank the applicable percentage, not to exceed 10%, under sub. (1). The commissioner may withdraw or suspend a percentage established under this subsection and, in such case, may specify how outstanding investments shall be treated by the bank. Among the factors the commissioner may consider in establishing, withdrawing or suspending a percentage established under this subsection are the bank's capital, assets, management and liquidity ratio and its capital ratio.

History: 1985 a. 153.

221.307 Additional banking authority. (1) Subject to any regulatory approval required by law and subject to sub. (2), a

bank, directly or through a subsidiary, may undertake any activity, exercise any power or offer any financially related product or service in this state that any other provider of financial products or services may undertake, exercise or provide or that the commissioner finds to be financially related.

(2) The activities, powers, products and services that may be undertaken, exercised or offered by banks under sub. (1) are limited to those specified by rule of the commissioner of banking and, with respect to loans under s. 221.295 (1) and investments under s. 221.295 (2), are subject to the limitations set forth in s. 221.295. The commissioner may direct any bank to cease any activity, the exercise of any power or the offering of any product or service authorized by rule under this subsection. Among the factors that the commissioner may consider in so directing a bank are the bank's capital, assets, management and liquidity ratio and its capital ratio.

(3) This section does not authorize a bank, directly or through a subsidiary, to engage in the business of underwriting insurance.

History: 1985 a. 325.

221.30 Banks not to hold own stock. (1) No bank shall be the holder of or purchaser of any portion of its capital stock, capital notes or debentures unless such purchase shall be necessary to prevent loss upon a debt previously contracted in good faith. Stock, notes or debentures so purchased shall in no case be held by the bank for a longer time than 6 months if the stock, notes or debentures can be sold for the amount of the claim of the bank against the same, and it must be sold for the best price obtainable within one year, or it shall be canceled, and shall then amount to a reduction of the capital stock, capital notes or debentures; provided, that, if such reduction shall reduce the capital stock below the minimum required by law, such capital stock shall be again increased to the amount required by law as provided herein.

(2) No bank shall loan any part of its capital, surplus or deposits on the capital stock, capital notes or debentures of its own bank as collateral security.

221.31 Loans to bank officials; penalty. (1) No bank may loan without security more than $10,000 in the aggregate to any officer or employe, nor more than $25,000 in the aggregate to any director, and any loan in excess of these limits is subject to the following conditions:

(a) The loan shall previously be approved by resolution of the board of directors recorded in its minutes or be within the limits of a line of credit approved for such director, officer or employe at least annually by resolution of the board of directors recorded in its minutes.

(b) The amount of any loan in excess of these limits shall be secured in full by indorsement or collateral security, the sufficiency of which shall be reviewed by the board of directors at its first meeting after each new loan.

(2) Every officer, director or employe of any bank who in violation of this section, directly or indirectly, borrows or otherwise procures for personal use money, funds or property of such bank or through use of personal credit or accommodation of another person or by acceptance for discount at the bank of any note, bond or evidence of debt which he or she knows or has reason to know is worth less than the price at which it is accepted as an asset, shall be imprisoned in the Wisconsin state prisons not more than 10 years.

History: 1977 c. 418; 1979 c. 308; 1983 a. 119.

221.32 Limit on mortgage loans. No bank shall lend any part of its capital, surplus or deposits upon real estate mortgages or on any other form of real estate security, directly or as collateral, except in this and adjoining states; nor shall it lend on real estate mortgages or any other form of real estate security, an amount exceeding 50 per cent of the aggregate of its capital, surplus and deposits, except when authorized as to amount, security and location by resolution of two-thirds of its board of directors properly entered upon its minutes.

Cross Reference: See 138.051 and 138.052 for residential mortgage loans, 138.053 for interest adjustment clauses, and 138.055 and 138.056 for variable interest rate clauses.

221.325 Health and accident insurance as additional collateral. The provisions of s. 215.21 (10) (b) shall be applicable to banks and for such purpose the word "association" therein means banks subject to this chapter.

221.33 Assets not to be pledged as security. (1) Except as provided in s. 34.07, no bank or bank officer shall give preference to any depositor or creditor by pledging the assets of the bank as collateral security. A state bank may deposit with the treasurer of the United States, or in the custody of federal reserve banks or branches thereof designated by the judges of the several courts of bankruptcy, so much of its assets not exceeding its capital and surplus as may be necessary under the act of congress approved June 25, 1910, and all amendments thereof, to qualify as a depository for postal savings funds, other government deposits and as depository for bankrupt estates, debtors, corporations and railroads under reorganization under U.S. bankruptcy laws, and amendments thereto, and receivers, trustees and other officers thereof appointed by any U.S. district court or by any bankruptcy court of the United States and that in acting as such depository a state bank shall have all the rights and privileges granted to banking institutions under section 61 of the U.S. bankruptcy act, and amendments thereto; and any bank may borrow money for temporary purposes, and may pledge assets of the bank not exceeding 50% in excess of the amount borrowed as collateral security therefor. Any state bank so authorized by the commissioner of banking, who complies with s. 223.02, shall be exempt from furnishing the bond specified in s. 221.04 (6), and shall be entitled to the same exemption as to making and filing any oath or giving any bond or security as is conferred on trust company banks by s. 223.03 (8), but it is unlawful for any bank to borrow money unless the board of directors has adopted a resolution designating the bank from which the money may be borrowed, the maximum amount for which the bank may become indebted at any one time, and the names of the officers who may sign the promissory note evidencing the indebtedness. A bank may pledge assets in an amount not to exceed 4 times the amount of its capital and surplus to the federal reserve bank (as fiscal agent of the United States) of the federal reserve district in which it is located, except that no such pledge shall be made in excess of the amount of its capital and surplus without the consent of the commissioner of banking. Whenever it appears that a bank is borrowing habitually for the purpose of rediscounting, the commissioner may require the bank to repay money so borrowed. Nothing herein contained shall prevent any bank from rediscounting in good faith and endorsing any of its negotiable notes if the same has been authorized by a recorded resolution of the board of directors.

bank shall contain a record of each bond executed and approved.

(3) Such bond shall be sufficient in amount to protect the bank from loss by reason of acts of fraud or dishonesty including forgery, theft, embezzlement, wrongful abstraction or misapplication on the part of the person, directly or through connivance with others. At any time the commissioner may require additional bond or security, when in his opinion, the bonds then executed and approved are insufficient.

(4) Every such bond shall provide that no cancellation or other termination of the bond shall be effective unless the surety gives in advance at least 10 days' written notice by registered mail to the commissioner. If the bond is canceled or terminated at the request of the insured (employer), the surety shall give the written notice to the commissioner within 10 days after the receipt of such request.

(5) For reasons which he deems valid and sufficient the commissioner may waive as to the cancellation or termination of any such bond the 10-day written notice in advance required by sub. (4) (a) and may give his written consent to the termination or cancellation being made effective as of a date agreed upon and requested by the surety and the bank.

(6) The provisions required by sub. (4) to be in every such bond shall not in any way modify, impair or otherwise affect or render invalid a provision therein to the effect that the bond shall terminate as to any person covered thereby upon the discovery by the bank of any dishonest act on the part of such person.

(7) Any violation of the provisions contained in subs. (1) and (2) shall subject the bank to a fine of $100 per day for each consecutive day of such violation and it shall be the duty of the attorney general to recover any such penalties by action for and on behalf of the state.

History: 1983 a. 119, 538.

224.07 Checks to clear at par. Checks drawn on any bank or trust company, organized under the laws of this state, shall be cleared at par by the bank or trust company on which they are drawn. Any bank or trust company, or officer or employe thereof, who violates the provisions of this section shall be guilty of a misdemeanor and punished as provided in s. 939.61.

224.075 Financially related services tie-ins. In any transaction conducted by a bank, bank holding company or a subsidiary of either with a customer who is also a customer of any other subsidiary of any of them, the customer shall be given a notice in 12-point boldface type in substantially the following form:

NOTICE OF RELATIONSHIP

This company, ... (insert name and address of bank, bank holding company or subsidiary), is related to .... (insert name and address of bank, bank holding company or subsidiary) of which you are also a customer. You may not be compelled to buy any product or service from either of the above companies or any other related company in order to participate in this transaction.

If you feel that you have been compelled to buy any product or service from either of the above companies or any other related company in order to participate in this transaction, you should contact the management of either of the above companies at either of the above addresses or the office of the commissioner of banking at .... (insert address).

History: 1983 a. 325.

224.08 Account disclosures. (1) Every bank shall provide a disclosure statement, which may include a separate interest rate table or fee schedule or both, for each account offered by the bank, setting forth all of the following information:

(a) A description of the account.

(b) The conditions, if any, on which the account is offered.

(c) The terms of interest offered for the account.

(d) All fees charged for the account.

(2) Every bank shall provide the appropriate disclosure statement under sub. (1) to each depositor upon all of the following occasions:

(a) At the time of the depositor's initial deposit into the account.

(b) Upon any change in any of the information under sub. (1) (a) to (d) applicable to a depositor's account, other than a change in the interest rate of a variable interest rate account if the variability of the interest rate was disclosed at the time of initial deposit.

(3) Every bank shall provide the appropriate disclosure statement under sub. (1) to any person requesting the disclosure statement for an account.

(4) Disclosure statements provided under subs. (2) and (3) shall be accompanied by a brief description of all other accounts offered by the bank and a statement that more detailed information is available on request.

History: 1983 a. 325.

224.10 Indian loan funds. (1) ADMINISTRATION IN TRUST AS A LOAN FUND. The loan funds of any Indian tribe which are transferred to the custody of such tribe by the United States, including any outstanding loan accounts, shall be administered as follows:

(a) The funds shall be held in trust by the tribe or a legal entity thereof as an Indian loan fund, for the purpose of making loans to members of the tribe.

(b) Management of an Indian loan fund shall be vested in a board of trustees, which may hire necessary personnel to administer the loan fund. The board of trustees shall consist of 5 members of the tribe and shall be appointed annually by the governing body of the tribe.

(c) The Indian loan fund in custody of the Menominee Indian Tribe and administered by a board of trustees appointed by that tribe shall, at the termination of federal control, be administered, subject to this section, by a board of 5 trustees appointed annually by the stockholders of the corporation described in s. 710.05, 1973 stats., and shall be used for making loans to those who were enrolled tribal members as proclaimed by the secretary of the interior as of June 17, 1954, and their spouses and descendants and to any additional classes recommended by said trustees and approved by the commissioner of banking.

(2) EXAMINATION BY THE OFFICE OF THE COMMISSIONER OF BANKING. (a) Indian loan funds under this section shall be examined by the office of the commissioner of banking under s. 220.04, and shall be subject to said section in the same manner as the institutions designated therein, and shall pay the cost of such examination and assessments as provided in s. 220.05.

(b) The commissioner of banking, with the approval of the banking review board, shall establish rules governing the management and operation of Indian loan funds. Such rules shall establish the purposes for which loans may be made; permissible interest rates and fees; security requirements; time and manner of repayment; general procedures to be followed in making loans; action which shall be taken in the

Chapter Bkg 16

REAL ESTATE BROKERAGE SERVICES

Bkg 16.01 Real estate brokerage services
Bkg 16.02 Finding of the commissioner
Bkg 16.03 Approval procedure
Bkg 16.04 Reports required
Bkg 16.05 Bank offering of real estate brokerage services
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Bkg 16.07 Discretionary authority of the commissioner
Bkg 16.08 Compliance with other laws

Bkg 16.01 Real estate brokerage services. In this chapter "real estate brokerage services" includes the attempt or arrangement of the purchase, sale, rental or exchange of an interest or estate in real estate. "Real estate brokerage services" does not include real estate development or investment activities.

History: Cr. Register, June, 1987, No. 378, eff. 7-1-87.

Bkg 16.02 Finding of the commissioner. Pursuant to s. 221.297 (1), Stats., the commissioner finds that a real estate brokerage service is a financially related service and it is a service that other financial services providers may undertake.

History: Cr. Register, June, 1987, No. 378, eff. 7-1-87.

Bkg 16.03 Approval procedure. Organization of a division or subsidiary shall be made by first obtaining written approval of the commissioner and otherwise complying with the s. Bkg 3.04 and s. 221.297, Stats. Changes, additional investment or loans to the real estate brokerage service by the bank or its subsidiary are also required to have prior written approval of the commissioner. The commissioner shall have 60 days from the date of receipt of the application in which the action shall be approved or disapproved.

History: Cr. Register, June, 1987, No. 378, eff. 7-1-87.

Bkg 16.04 Reports required. The real estate brokerage division or subsidiary shall provide to the commissioner an annual financial statement within 90 days from the end of the fiscal year.

History: Cr. Register, June, 1987, No. 378, eff. 7-1-87.

Bkg 16.05 Bank offering of real estate brokerage services. A bank may provide real estate brokerage services directly or through a subsidiary at its home office, authorized branch offices, and other locations, provided, the bank does not make loans, accept deposits, provide trust services other than as permitted by s. 221.04 (6), Stats., or cash checks or other negotiable instruments at such other locations. Notification of locations shall be made annually as part of the financial statement. Prior approval by the commissioner of such other locations is not required.

History: Cr. Register, June, 1987, No. 378, eff. 7-1-87.

Bkg 16.06 Real estate services provided by bank employes. No officer or employe of a bank who personally approves a borrower's application with respect to a particular real estate loan shall receive any commission earned on the sale of the real estate related to the loan. Any such commission shall be paid directly to the bank.

History: Cr. Register, June, 1987, No. 378, eff. 7-1-87.

Bkg 16.07 Discretionary authority of the commissioner. The commissioner may, pursuant to s. 221.297, Stats., on an individual case basis, restrict, limit, pro-

hibit or revoke the authority of a bank to operate a real estate brokerage service division or subsidiary.

History: Cr. Register, June, 1987, No. 378, eff. 7-1-87.

Bkg 16.08 Compliance with other laws. The real estate brokerage services offered by a bank or its subsidiary shall comply with ch. 452, Stats., and other applicable laws and administrative rules.

History: Cr. Register, June, 1987, No. 378, eff. 7-1-87.

Good morning! Thank you Mr. Chairman and members of the committee for the opportunity to appear before the Senate Banking Committee today to discuss a matter which I believe is of increasing importance to the proper development of the financial services markets in this country. The distribution of insurance products by banking organizations is a necessary step in the logical evolution of the financial services industry. Much has been written on this subject and we are all aware of the struggles that have arisen as regulatory agencies deal with the realities of the marketplace which often fail to conform to the existing legal framework.

Before I proceed with my comments today, I would respectfully request that I be permitted to submit a written statement at a later date in addition to my oral testimony today and ask that it be made a part of the record.

As Superintendent of the New York State Banking Department I presently supervise over 35% of all state-chartered banking assets in the United States with banks ranging in size from 3 million to 70 billion dollars. The Department has supervisory responsibility over 17 types of financial institutions including commercial banks, thrifts, credit unions, foreign bank entities, mortgage bankers and brokers, small loan companies and check cashers. This is accomplished with a staff of 500 including bank examiners having an average of 15 years professional experience.

Your invitation requested testimony on the regulatory issues of bank entry into insurance and the safeguards necessary for consumer protection and safety and soundness. I would like to relate the history of our experience in New York State, our plans for the future and the safeguards which we feel are necessary. You have already heard testimony concerning the benefits that would accrue to the public if banks were permitted widespread participation in these markets. I will not attempt to expand on those remarks other than to say that, as a regulator charged under New York State law not only with the safety and soundness of the banking system but with promoting the welfare of the general public as well, I strongly support additional competition in insurance products for the benefit of the consumer.

The extent and history of existing insurance activities conducted by banks may not be fully appreciated. If it were, the concept might not appear so radical. Since 1864, national banks have been authorized to sell insurance products in communities of less than 5,000 population and credit life insurance has also long been a permissible banking activity. Currently, 16 states permit some form of bank insurance activity. Moreover, Congress in 1982 codified several exceptions to the prohibition on banks engaging in insurance and activities of some bank-holding companies have long been grandfathered. Additionally, many of our multi-national banks participate extensively in the insurance markets abroad.

In the Northeast states of New York, Connecticut and Massachusetts, banks have long been offering Savings Banks Life Insurance. Since 1938, savings banks have been selling that product to those who live or work in New York State. Currently there are more than one half million policies outstanding totaling over $12 billion, which represents approximately 3% of the New York life insurance markets. The success of SBLI for New York is, I believe, testimony to the attractiveness of the product in terms of cost and convenience and the quality of the supervisory environment.

In the almost 50-year period of its existence, our experience with savings banks life insurance has been excellent. The New York State Banking Department shares supervisory responsibility with the New York State Insurance Department. This relationship could serve as a model for functional regulation. The two departments alternate onsite examinations and emphasize different aspects of the institution's insurance activities. Although both supervisors are interested in the insurance operation, the Banking Department examination concentrates on investment asset quality and earnings while the insurance department emphasizes actuarial considerations and compliance with insurance regulations.

As you are probably aware, a Temporary State Commission on Banking, Insurance and Financial Services, the so-called

DeWind Commission, was appointed by Governor Cuomo. The purpose of the Commission was to study the financial services industry in New York and to recommend a legal and regulatory framework to foster the orderly development of the financial markets into the 1990s and beyond.

Our current thinking, consistent with major recommendations of that report, envisions the gradual entry of banking into insurance, starting with agency and brokerage, leading eventually to life insurance underwriting and ultimately into property and casualty underwriting. We also propose comprehensive safeguards to protect the consumer and to prevent possible coercive abuses in the sale of insurance services by banks. Included are requirements for dual supervision by the Banking and Insurance Departments, professional standards for bank insurance agents, disclosure requirements, a prohibition against discussion of insurance by a bank or its agent until after the loan application has been acted upon in writing, as well as a 30-day cooling off period, during which time the policy can be cancelled without undue penalty.

I have given you some background on where we are and where we would like to be. But for me as a regulator and you as the premier legislative body in the land, what are the major safety and soundness considerations in terms of protecting the bank from difficulties in non-bank areas and how can we provide an optimum regulatory framework to supervise diverse activities?

Organizational structure can be an important component in insulating one affiliate from the consequences of financial difficulty in another. We believe that in a hierarchy of options ranging upward from bank departments through bank affiliates and holding company subsidiaries, the latter provides the best legal avenue for insulation of insurance underwriting activities. The New York legislation envisions separate banking and insurance subsidiaries and mandates functional regulation of the separate lines of business.

A combination of competent functional regulation, sufficient capitalization, and gradual entry into insurance activities, with an emphasis on first developing organizational expertise to handle these ventures, will provide reasonable assurance that bank entry into insurance can be accomplished in a safe and sound manner.

If I may note, one area of potential risk, inter-affiliate transactions, has already been addressed by Congress in the Banking Affiliates Act of 1982 which significantly strengthened Section 23A of the Federal Reserve Act. Loans and transfers of assets from an insured bank to a non-bank affiliate are permitted only in limited amounts, on a fully secured basis and at arms length.

Finally, I believe the addition of insurance products will add to the overall safety and soundness of the banking system by providing banking organizations with expanded market opportunities to diversify sources of income and risk.

I would like to thank the Committee for inviting me to comment on this matter which has implications far beyond the mere delivery of insurance products to the public. The Competitive Banking Equality Act of 1987 now being considered would, by imposing a moratorium on insurance and other activities of banks, curtail the ability of individual states to prudently innovate. This is a states rights issue and the legislation now being proposed would undermine our Federal system and the dual banking concept that has served this nation so well. I am confident that a fair and impartial review will result in legislation accommodating the natural development of the financial services industry, consistent with safety and soundness requirements.

As we have seen in the context of regional interstate bank expansion, the state and federal agencies have demonstrated the capacity to develop a coordinated regulatory environment.

If the Congress were to legislate integration of banking and insurance, the existing regulatory framework has the flexibility to permit implementation of the federal policy through individual state initiatives.

In this, the Bicentennial year of our Constitution, it seems appropriate to remember that the doctrine of states' rights in our system both serves community needs and provides new ideas which can be implemented at the national level. I find this especially true in the area of banking regulation. In New York State we have been at the forefront in instituting policies that have had national influence. Among our initiatives have been: reciprocal interstate banking, funds availability and truth-in-savings. Therefore, I am disappointed that a moratorium is contemplated because it may have a chilling effect on activities at the state level which serve as a test bed for proving what can be done.

Thank you for your courteous attention. I will be happy to address any questions you may have.

The CHAIRMAN. Thank you very much, Ms. Considine.

Our last witness is James Corcoran, superintendent of insurance, State of New York. Mr. Corcoran, you've got 5 minutes for your oral statement. We will print your written statement in full in the record.

STATEMENT OF JAMES P. CORCORAN, SUPERINTENDENT OF INSURANCE, STATE OF NEW YORK

Mr. CORCORAN. Thank you, Mr. Chairman. I will try to paraphrase as quickly as I can. Of course, many of the things that Superintendent Considine stated, I am fully in support of, particularly the Governor's effort to allow banks to get into the insurance business.

You will note from my testimony I have taken a slightly different approach to it and really it's a can-do approach. I have outlined in there the regulatory concerns that must be faced before banks are allowed entry into insurance, from an insurance regulator's perspective. You will note from my testimony that the DeWind recommendations were broad-sweeping recommendations regarding bank entry into the insurance business as well as the insurance business into banking, but it also stated and stressed regulatory safeguards that must first be enacted in order to assure clarity of regulation and to assure that the insurance companies are walled off.

CONSUMER PROTECTION

Of course, the most important piece of all is to note that the thrust in New York was consumer protection and to provide the consumers with the ability to have the competitive advantages of banks entering and selling insurance.

The first thrust you will see in the notes, we talk about holding company subsidiaries. It's very important and the DeWind recommendations said allowing banks to assume insurance risks directly would present such serious questions of risk to the safety and soundness of the bank, exposure of the Federal deposit insurance guaranty funds to novel risks, and duplicative and possibly conflicting supervision and accounting issues—to name only a few of the more obvious problems—that it seems quite doubtful that any expected benefits to the public or the institutions involved would be sufficient to justify such a dramatic departure.

For that reason, they stressed over and over that it be a separate subsidiary, wall-off assets, and as Superintendent Considine has stressed, functional regulation.

I would also note that we stress here intraholding company transactions and the strong holding company law that exists in the State of New York regarding intraholding company transactions, especially dealing with the insurance companies.

I'd like to stress to the committee that it was that act, that strong holding company act, that spared the State of New York the agony of Baldwin-United. The oversight of intraholding company transactions to make sure the insurance company is not being used and the expression was a "cash cow" to extract from it the assets needed to pay policyholders.

There's also a section about third party conflicts to assure that bank holding companies or insurance holding companies are treating each other evenhandedly and at arm's length, and limits on investments were recommended to assure that the aggregate limit of 2 percent of investments in such institutions by a bank to assure that the banks aren't putting too much of their assets into insurance operations.

As Superintendent Considine has stressed, the safeguards were also recommended concerning tie-in sales which I'm sure you will hear a lot about, but we in the State of New York have a strong will to regulate, a willingness to make sure that when we enact laws that have been suggested in the Governor's bills regarding banks or insurance to be sure that tie-in sales are prohibited by strict regulation and perhaps draconian penalties for violations.

Customer service and protection has been stressed, making sure that the individuals dealing in the banks, selling insurance, are adequately licensed by my department, as would any other agent be licensed.

And the question of multiple jurisdictions—I think that's a question that I've raised in the last three pages that demonstrate the issues that should be addressed, but not indicating at all that they cannot be answered.

An important issue here is a discussion that we had with OCC, the Comptroller of the Currency, when a particular insurance company operation was permitted to be held by a bank and we had a dialog regarding who would hold the assets in case of an insolvency, making sure that if the bank became insolvent that the FDIC or anyone else or any banking regulator would not come in and seize those assets that are clearly assets designated for the benefit of policyholders.

Now we had agreement between ourselves, these regulatory bodies, but the reason I stressed this in our paper and our testimony is to bring forward to this committee these concerns, but to also stress to you they were solved through dialog. I would suggest that that legislation be put in place to make sure there's no overlapping, unnecessary fuzziness concerning who is regulating what and what powers are present, so that one assertion cannot be made, an assertion that was made by the Comptroller's office initially, that the ability of the Insurance Department of the State of New York to examine that insurance company was limited by the acquiescence of the Comptroller. That brought great concern to me and we had a dialog regarding it and resolved it.

So although the testimony that you see me presenting says there are regulatory concerns, these regulatory concerns all can be addressed and overcome. I think that's the crucial point of my testimony and I would be open to questions and I appreciate the opportunity to come forward.

[The complete prepared statement of James P. Corcoran follows:]

TESTIMONY ON BANKS AND INSURANCE
BY SUPERINTENDENT JAMES P. CORCORAN
BEFORE THE U.S. SENATE COMMITTEE ON BANKING,
HOUSING, AND URBAN AFFAIRS

I. INTRODUCTION

Good morning. My name is James P. Corcoran and I am Superintendent of Insurance for the State of New York. I wish to thank Chairman Proxmire and members of the Committee for the opportunity to appear before you today.

The question of whether New York banks and insurers should be permitted to expand into each other's domain was explored in depth by a Commission[1] appointed by Governor Mario M. Cuomo in September 1983. The "DeWind" Commission--named after the Commission's Chairman, Adrian DeWind, a senior partner in a Manhattan-based law firm--released an exhaustive report on February 15, 1984 recommending sweeping regulatory changes to strengthen the State's financial industry and its services to consumers.

The report contains specific proposals designed to eliminate many of the barriers separating banks, insurance companies and other financial institutions. We have provided a copy of the DeWind Report to your Committee.

Legislation to implement the findings of the DeWind Commission was first introduced in 1984 by Governor Cuomo, and supported by our Department. Since then, an intensive lobbying campaign has been waged--spearheaded by various insurance agent and broker groups--to block passage of the Governor's bills. Thus far, these efforts have proven successful in each of the four years that the Governor has submitted a legislative package based on the DeWind Report.[2] We have forwarded the most recent Governor's bills, along with the memos of support, to your Committee.

Most of the major advantages and disadvantages of allowing banks and insurers to broaden their services are well documented in the DeWind Report and other sources, and I'm sure will be reviewed today in depth by other speakers. I do not intend to go over that ground in my testimony; although, as I stated earlier, the Department supports the general findings of the DeWind Commission. Instead I would like to discuss some of the insufficiencies in the current regulatory framework which must be addressed before banking and insurance legislation is enacted. This is a worthy area of concern, in my view, because any advantages to be gained from removing barriers between banks and insurers will surely be negated if strong regulatory safeguards are not in place at the time of implementation.

I will begin with a discussion of the Department's regulatory concerns with respect to banks as insurers; I will then review some of the problems associated with banks that act as insurance agents or brokers; and, finally, I will express my thoughts concerning multiple regulatory jurisdictions and guaranty funds.

II. BANKS AS INSURERS

A. Holding Companies

1. Separate Subsidiaries

It is of primary importance to state at the outset that there exists a clear distinction between permitting banks to write insurance directly and permitting them to own insurance subsidiaries. The latter approach has been endorsed by the DeWind Commission, the New York Insurance Department and Governor Cuomo. The former approach is a prescription for disaster. Some of the major concerns associated with permitting banks to write insurance directly were summarized by the DeWind Commission:

> Allowing banks to assume insurance risks directly would present such serious questions of risk to the safety and soundness of the bank, exposure of the federal deposit insurance guaranty funds to novel risks, and duplicative and possibly conflicting supervision and accounting issues -- to name only a few of the more obvious problems -- that it seems quite doubtful that any expected benefits to the public or the institutions involved would be sufficient to justify such a dramatic departure from existing industry and regulatory structure.[3]

Later in its Report, the Commission expressed its support for separate subsidiaries:

> In order to minimize risk to both bank depositors and insurance company policyholders which could result from affiliations between banks and insurance companies, the Commission expresses a preference for having these different activities conducted in separate corporate subsidiaries of a parent holding company. The holding company structure avoids placing the capital of one institution directly at risk in the business of the other, encourages separation of management and operations and facilitates "regulation by function" and control of inter-corporate transactions.[4]

2. Intra-Holding Company Transactions

New York has enacted some of this nation's most stringent insurance holding companies laws, particularly with regard to financial transactions between parent and subsidiaries or among subsidiaries of the same holding company. One of the New York Law's chief provisions requires that our Department review significant transactions between domestic insurers and their parents or affiliates. In addition, transactions exceeding five percent of a domestic insurer's admitted assets are subject to our prior approval.

The primary purpose of such a requirement is to assure that transactions occurring within the holding company structure that affect the licensed insurer are fair, equitable and reasonable. Put another way, holding company laws were enacted in New York to ensure that the financial and operational

integrity of each of our domestic insurance companies is preserved, i.e., that each is walled off from its affiliates and maintains a separate operating identity. The New York holding company laws recently preserved the solvency of two New York subsidiaries[5] of the Baldwin-United group, while six of their affiliates in other states were involved in liquidation proceedings conducted by various insurance departments throughout the country.

The Baldwin-United collapse was directly attributable to imprudent inter-company investments within the Baldwin corporate family.[6] Following Baldwin's failure, I chaired a working group formed by the National Association of Insurance Commissioners (NAIC) to help strengthen the NAIC's Model Holding Company Act. The Model Act, which closely resembles existing New York Law, was adopted in June 1986. Most states, however, have thus far not adopted the new model; holding company statutes in these states are still based on the earlier, weaker NAIC Model Act.

The lack of strong statewide holding company statutes of course affects all policyholders, regardless of whether the parent is or is not a bank. However, the problem can become particularly worrisome when the parent and the subsidiary are in industries that are experiencing financial difficulties. During the past few years, a record number of insolvencies--some directly related to parents siphoning funds from their affiliates--have occurred in the insurance industry. The failure of many saving and loan associations is also a pressing problem at this time. When players with such inherent volatility combine under the same corporate roof in a state that lacks effective holding company laws, the threat of insolvency intensifies.

When banks and insurers combine, insurance and bank regulators are likely to have conflicting regulatory concerns since both are charged with oversight of industries that have been granted unique fiduciary responsibilities. For example, insurers that are parents to banks may decide to infuse capital to "shore up" their bank affiliates in times of distress, to the detriment of the insurer's policyholders. Likewise, deposits in a bank that is a parent to an insurer may be in jeopardy when the bank opts to aid its ailing affiliate through a capital infusion. The New York Insurance Department has been able to call upon nonbank parents to infuse hundreds of millions of dollars into New York insurance subsidiaries over the past few years, based upon our financial examinations of the New York companies. If we were dealing with parent banks in these situations, our efforts could have been obstructed by numerous regulatory roadblocks on both the state and national level.

3. Third-Party Conflicts of Interest

Should banks be permitted to acquire insurance subsidiaries, regulators must become aware of any efforts by banks to encourage their insurance affiliates to invest in financially impaired corporations that have been extended credit by the parent bank. Such investments would make no economic sense for the insurer, but could enhance the likelihood that the corporation would make good on loans from the parent bank that otherwise may have proved uncollectible.

Even New York's strict holding company provisions do not address the above point, primarily because New York banks never have been permitted to own insurance companies. Recognizing this need, New York has included in its financial services bill a requirement that insurers report to the Department any significant portfolio transactions where the insurer knows, or should know, that the third party has a significant commercial banking relationship with a bank affiliated with the insurer. Should banks be allowed to own insurers, it would be imperative that similar legislation be implemented in every state.

A conflict of interest may also arise when a bank extends credit preferentially to a financially unsound company in which an insurer subsidiary of the bank has a significant financial stake. The extension of credit in this case could conceivably bolster the portfolio of the insurer subsidiary.

Similar problems can also result with respect to financial guarantee insurance. Financial guarantee insurance is a form of insurance in which an insurer promises to pay the debt of the borrower if the borrower defaults. The insurance works much like a standby letter of credit offered by banks in connection with the offering of corporate, municipal or other types of debt. In 1985, Citibank, N.A. was granted permission by the Office of the Comptroller of the Currency (OCC) to own 80% of AMBAC Indemnity Corporation, an insurer that writes financial guarantee insurance for municipal bond offerings. Approval was granted primarily because the OCC determined that financial guarantee insurance is "...functionally equivalent to a standby letter of credit...."

Major money center banks have indicated an interest in writing financial guarantee insurance on corporate debt. Here again, without significant regulatory safeguards the potential for abuse is great. Banks with loans outstanding to corporations that border on insolvency may be able to convince affiliate insurers to guarantee corporate bond offerings to increase the likelihood that they (the bank) will be repaid. If down the road the corporation is unable to meet its obligations to bondholders, the insurer assumes the responsibility. Should that insurer lack the necessary assets, then the burden falls on all insurers that participate in the security fund (assuming financial guarantee insurance is covered by a state's security fund).

B. Limits on Investments

Sound diversification standards dictate that if banks are to be permitted to own insurers (and vice versa), certain investment limitations should be imposed. Based upon DeWind Commission recommendations, Governor Cuomo's legislation would limit all such investments to an aggregate limit of 2% of the investing institution's assets.

III. BANKS AS INSURANCE AGENTS AND BROKERS

The DeWind Commission and Governor Cuomo recognized the potential benefits to consumers resulting from the entry of banks into the insurance agency and brokerage business. Increased competition is expected to lead to greater convenience to customers, innovative sales and distribution methods, improved and more specialized services, and more favorable pricing.

The CHAIRMAN. Thank you very much, Superintendent Corcoran.

Mr. Haase and Mr. Galecki, in reading your separate testimony I'm reminded of a story President Kennedy used to tell. In 1962, he sent a senior foreign service officer and a Marine colonel to Vietnam to get a report on the progress being made by the Diem regime in defeating the Viet Cong. When he got those separate reports they were so contradictory he called them both over to the oval office and asked if they had been in the same country.

Well, you're both from Wisconsin. But, Mr. Haase, you oppose allowing banks into the insurance business stating on page 4 of your testimony that "in the end I only see more problems, less competition, and nothing gained."

Mr. Galecki, on the other hand, contends that since 1975 banks have offered insurance services in Wisconsin and he believes this has had a positive effect.

Can you explain to us how you arrive at such different recommendations from your common State experience on this contentious issue?

DIFFERENCE OF OPINION

Mr. HAASE. Yes, I believe so, Senator. My concern here is quite different than what Mr. Galecki is talking about. He was talking more about banks being able to sell insurance. I don't think he was talking particularly about banks underwriting insurance. So that, in that way, I can see where he could say that perhaps there is more competition.

My concern is that when you allow banks to become insurance companies or insurance companies to become banks, if it's a single entity, you have the regulatory problem. But even if it's a holding company entity, there is such an opportunity for people to be in a bank and then buy their insurance there, not directly but indirectly as we were talking about earlier, simply if you want to buy your car here you'd better buy your automobile insurance here—they don't say that but they think that—that it seems to me that in the end you're going to have, just as we have seen small banks being picked up by big banks—you're going to find that that will be increased.

Once you have the big banks and the big insurance companies becoming one, whether they are doing it through a holding company or whether they are doing it as a single entity, they are going to be able to offer so many more things than the small banks that the small insurance company is either going to give up or be acquired by the larger one.

The CHAIRMAN. So you oppose banks either selling or underwriting insurance and, as I understand it, Mr. Galecki, you favor both?

Mr. GALECKI. Yes, I do.

Mr. HAASE. Let me just say, I'm not overly opposed to banks selling insurance as an agent.

The CHAIRMAN. All right, fine. Go right ahead, Mr. Galecki.

Mr. GALECKI. As you are aware, First Wisconsin is the largest bank in Wisconsin at the present time.

The CHAIRMAN. About to be superseded by an Ohio bank.

Mr. GALECKI. Possibly.

The CHAIRMAN. Unfortunately.

Mr. GALECKI. They were grandfathered in insurance and had been offering a full line of insurance for many, many years. They have allowed their correspondent banks to also offer these services and we have not had any consumer complaints regarding this whatsoever over the years.

So I think that competition is great, regulation is great, but I think that the banks will do a good job with this. They are not going to jump into a lot of services if they are not sure they can handle them correctly. They are not going to take risks.

Wisconsin has been a conservative State and I believe will continue to be conservative.

The CHAIRMAN. Mr. Haase, have you received any consumer complaints about banks selling insurance?

Mr. HAASE. We always do when it comes to credit life and credit disability, yes.

In the State of Wisconsin the banks and the finance companies are supposed to tell you you don't have to buy this insurance at all and if you do buy it you don't have to buy it from us. But we have had many instances where the financial institution either has conveniently forgotten to do that or even if they did say it the borrower does not realize that they don't have to do this and they still think they have to buy it.

The CHAIRMAN. How about general property and casualty insurance?

Mr. HAASE. I'm not too aware of banks selling that in the State of Wisconsin, but I have had none that I'm aware of as far as that. I suppose if they are selling it to any degree we would have complaints from agents, but that would be all.

The CHAIRMAN. Mr. Galecki, your position is very clear on selling insurance. You feel there is no problem with that.

How about underwriting? Are you just as emphatic about that, that that's a good idea, banks underwriting insurance?

Mr. GALECKI. Yes. I do not believe that that would be a problem.

I'd like to go back to Commissioner Haase's statement about credit life and disability. I think that—I don't know if it's in all States, but in Wisconsin, all consumers must sign if they want the insurance or if they don't want the insurance. It would seem to me if someone feels that they are subjected to buying the insurance and sign and then do not come up and complain about it, I would be very surprised.

When we make our examinations, if we find that insurance has not been signed for, we require the company to go back and either get it signed or return the premium. There are many, many types of regulations that will take care of that.

The CHAIRMAN. Senator Sasser.

Senator SASSER. Thank you, Mr. Chairman.

COST OF CREDIT LIFE INSURANCE

Mr. Haase, we had an insurance commissioner down in our State of Tennessee which I might say was also Republican, and he said this about credit life insurance being sold by the banks in our State. I quote him. He said, "Every bank that I know of sells credit

insurance at the maximum price allowed by law and makes no attempt to sell it at a price that would produce a fair return of benefits to consumer."

Is this a fair characterization of this type of credit life insurance activity by banks based on your experience in Wisconsin?

Mr. HAASE. Yes, Senator. I believe it's true everywhere. Whatever we set as the most they can charge, that's what they are going to charge. I've never seen anybody charge less than that and that's why from time to time we keep lowering it. It used to be $2 per $100 of loan. Then it went to $1. Then it went to 75 cents, then to 60 cents and then to 40 cents, and it's only done by the regulator. Certainly it isn't done by either the banks or the financial institutions—not just banks—or the insurance companies.

Senator SASSER. What's been your experience with that, Mr. Corcoran?

Mr. CORCORAN. Well, in New York we resolved that problem by compelling loss ratios. If they sell credit life insurance, every dollar they take in they have to pay out 65 cents in benefits to stabilize that market.

There was a problem. It was responded to by regulation and we feel that in that and in some other areas of insurance we responded in that fashion and took care of that problem.

Senator SASSER. So then you agree with something Mr. Haase said before you got here, impliedly, that insurance and banking are areas where we have to have significant regulation?

Mr. CORCORAN. Absolutely.

Senator SASSER. Unfortunately, we in the Congress are learning that airlines also fit into that category. [Laughter.]

Let me direct this question also to our two insurance commissioners here. Start with you, Mr. Haase.

The National Association of Insurance Commissioners has adopted a model Unfair Trade Practices Act which requires that a lender bank or others, who solicit insurance must explain in writing to the borrower that insurance related to the extension of credit may be purchased somewhere else from another agent of the borrower's choice. And in certain circumstances, this particular model act about would require that a commitment in writing be made as to the loan or credit extension before the lender may solicit insurance.

Now, Mr. Haase, would that take care of the problem you are concerned about with regard to the borrower feeling that well, I'd better buy this insurance from the lender or otherwise I may not get this loan?

Mr. HAASE. Let me say this. My concerns are much less in the area of a financial institution selling insurance than they are of a financial institution becoming an insurance company.

But I still believe that even—we've had that law in Wisconsin for a long time—that people still think that if I don't buy this whatever it is—credit life or if they were selling mortgage guaranty insurance—if they don't get it from that bank they're not going to make the loan. I'm not sure that it has the effect that the people who wrote the laws, including myself, would like it to have.

But I'm not as worried about that end of it as I am about the other end of it. That's just simply a question of how you sell insur-

ance. There's no risk to anybody in particular there. My concern is when you get a bank-insurance company, then that's my real concern.

Senator SASSER. Do you want to respond to that, Mr. Corcoran?

Mr. CORCORAN. Yes, Senator. The Governor's proposal would go even further than that. I can list them quickly for you. The lender who sells insurance is prohibited from soliciting the insurance from a prospective borrower prior to the approval of the credit application. The lender is required to provide a 30-day cancellation privilege for policies sold in connection with the extension of credit, and lenders are prohibited from engaging in delaying tactics that would penalize borrowers who obtained insurance coverage through agents or brokers or insurers of their own choice.

Governor Cuomo's proposal well recognizes this problem and goes even further. He gives the Superintendent of Insurance rather draconian powers to respond if we find an abuse in that area to take the license of a bank dealing in that fashion.

Senator SASSER. Let me talk about something here that we haven't discussed and something that's important to me, and that relates to benefits to consumers.

CONSUMER BENEFITS

What about the benefits to consumers? Would expanded activities by banks in the insurance field result in insurance being sold at a lower cost? Would it result in higher quality insurance products being made available to the consumer, or would the consumer simply feel, as Mr. Haase says some of them do, that they've got to buy the insurance from the bank regardless of price or regardless of quality simply because they want to get the loan?

Have any surveys been done on this? Do we have any evidence on this particular subject?

Mr. HAASE. If they have, I'm not aware of them.

Mr. GALECKI. I'm not aware of any.

Mr. CORCORAN. Senator, the benefit is not easily translated to the consumer per se. The benefit might well be in increasing insurance capacity. As we've gone through that recent property/casualty insurance crisis, one was a lack of capacity. That is defined as the ability of the industry to actually assume the risk. Entrance into the other entities might well assist that and that would indirectly benefit the consumer as far as availability of essential insurance coverage is concerned.

There is no evidence or demonstration relating to price. There is nothing that we can document, although I'm sure both sides will assert one way or the other beyond the availability of coverage. So it translates into a broader perspective perhaps.

Don't forget we've had some interesting entities controlling entire lines of insurance—piano companies, steel companies, oil companies—and they have contributed tremendously to the crisis due to the fact that they did not have the expertise or the oversight.

What we are suggesting in New York is here's our financial entity who wants to get into this business. First, we have a comprehensive regulation and oversight and, hopefully, that will increase

the capacity in the marketplace to make available to the public needed coverages that were so woefully unavailable within the last number of years.

Senator SASSER. Well, do you find this crunch is easing with regard to capacity of coverage?

Mr. CORCORAN. I think that we are going through a period of exhaustion. I think that the crunch is not over with. There is some stabilizing in the marketplace. There is a need to look at the prices, as we are doing in New York, establishing oversight. But, no, I don't think the crisis per se is over. I think we are going through an evolving stage and we'll see what occurs.

Senator SASSER. Ms. Considine, you wanted to respond?

Ms. CONSIDINE. Yes. It was just a question on are there any studies in terms of price. I think perhaps some of the consumer groups might be able to address that more adequately, but in terms of the savings bank life insurance experience in New York, the savings bank life insurance has been found to have lower premiums and Consumer Reports said anyone who is looking to purchase that type of savings life insurance should make sure that they include a savings bank life insurance as a comparison wherever they were to go. That's 50 years worth of experience in our State.

Senator SASSER. Thank you.

Do you have any questions, Senator Sanford?

Senator SANFORD. I apologize for arriving late, but I have your testimony and would like to put an opening statement in the record.

Senator SASSER. Without objection, it will be included in the record.

Senator SANFORD. Mr. Galecki, how does owning an insurance company help a bank to be a better bank?

Mr. GALECKI. I don't know if it allows it to be a better bank. I think it just offers them the other services to offer to their customers. I think that, as was brought out in all testimony before us today, that I think if we do not regulate it properly that Congress will have a major problem with it. I think the banks and other financial institutions are really looking for other ways of offering services to the consumer.

You have had many, many debates on the nonbank bank and everything else and I won't go into that, but the banks are needing other financial services to augment their earnings. I know for the State of Wisconsin that they would go in slowly, would look at what services were making money and which ones were not, and would only want to try to do that type of thing.

Senator SANFORD. Do you think that the banks ought to have this authority in order to make more money, to improve the insurance business, or to improve the banking business?

Mr. GALECKI. Since 1975, Wisconsin banks have already been doing this. So I don't have a problem with this. It hasn't opened the floodgates in Wisconsin. The banks that are offering it are making money in the process and I think that other banks are trying to get into these other services.

Senator SANFORD. Just because they make more money?

Mr. GALECKI. Correct.

Senator SANFORD. Do banks enter into the insurance business simply to make more money?

Mr. GALECKI. No, I think it offers them to also solicit their customers for other services.

Senator SANFORD. Well, you could carry that to the point of making it possible for them to sell household appliances at discount prices if just making money is all they're interested in.

Mr. GALECKI. Our interstate bill, if the Commissioner of Banking in the State of Wisconsin determines that that is financially related, could allow the banks to do that. That's correct.

Senator SANFORD. So if you sold refrigerators on credit, perhaps that justifies selling refrigerators.

Mr. GALECKI. That's correct, Senator.

Senator SANFORD. But you don't really propose that?

Mr. GALECKI. I would not approve it. Maybe Commissioner Haase would, but I wouldn't approve that.

Senator SANFORD. Let me ask Mr. Haase a question since both of you got such a glowing recommendation from my esteemed chairman. How does a combination of banking and insurance improve the insurance business?

Mr. HAASE. It doesn't.

Senator SANFORD. How does it hurt the insurance business?

Mr. HAASE. I don't know that it hurts the insurance business. It hurts the consumer, both of the banks and of the insurance companies, because it bothers me very much to hear people say this would be a good idea if we could just get the regulation. I haven't heard what the regulation is. It's obviously going to have to be Federal regulation because you can't let other States do as South Dakota did, which said all banks in South Dakota can sell insurance as long as they don't sell it in South Dakota.

So if you're going to do it at all, it has to be done federally. Now you have disrupted the system that we currently have insofar as regulation is concerned. The thing that bothers me financially is, a bank is going to want to become an insurance company so it's going to create a holding company taking the assets of the bank to create the holding company, then they are going to put the assets into the insurance company, and if the insurance company goes down the drain so does the bank, or vice-versa.

And I am very much concerned that each one by itself has enough trouble without adding the two together and I lose my life's savings because they did a lousy job of underwriting products liability or, on the other hand, my claim isn't paid because some foreign country can't pay a loan that the bank made to it. The two just are separate and ought to remain that way.

Senator SANFORD. You don't see any benefit and some danger?

Mr. HAASE. Not from the standpoint of the consumer, no, I do not.

Senator SANFORD. Did you want to add something, Mr. Corcoran?

Mr. CORCORAN. Yes, Senator. There are serious concerns, there's no doubt about it. But as you'll note from our testimony, Governor Cuomo's approach is to limit what they could invest in an insurance company, to wall off the assets, compose a strong holding company bill which would look at intraholding company transactions to make sure the scenario that the commissioner has pointed out

should not occur. Also, providing additional resources to the insurance regulator to make sure that they have the power to do it.

So they can address it well, as you will see from our testimony, on a State level.

As far as the Federal questions are concerned, I raise a number of questions and issues at the end of my testimony and note there, and let me note to you today, that we resolve those with the Federal regulator, and they well can be addressed the same way we did, by discussion, rather than in the form of legislation to make sure there's a clarity of who is regulating what asset and, in case of insolvency, the insurance assets are clearly designated just for the policy holders and the bank cannot touch it. There are many issues like that. There is an open dialog and I think we can approach these things without saying it's undoable, but it does require the will to regulate.

Senator SANFORD. Thank you very much. Shall we hear from the distinguished Commissioner from New York?

Ms. CONSIDINE. Thank you. If I may just add something to that. I think there are already laws that exist, one that was addressed by Congress in 1982, which was the Banking Affiliates Act. And at the moment, interaffiliate transactions are covered and no more than 10 percent can be lent to any other affiliate. It cannot exceed 20 percent for all affiliates, and there is a requirement for arm's length transactions and for these transactions to be counted for in a safe and sound manner.

So I think that we need to look at the regulation, but I think that what exists right now is adequate to start us. I think some of the points that Superintendent Corcoran has brought up in terms of the FDIC and the Comptroller and some of the correspondence that's gone back and forth—how do you do the regulation, what happens if there's a failure of one of the affiliates—but I think that's been worked out.

As I've said before, I would like to see it go with the State level. There are some States who may be able to handle this. There are others that may need more time.

Senator SASSER. Senator Karnes.

Senator KARNES. I have no questions, Mr. Chairman.

Senator SASSER. Well, I wish to thank our distinguished panel for appearing here today and giving us the benefit of their views.

Without objection, the committee will stand in recess until 9:30 tomorrow morning when we will once again take up the question of securities and banking.

Senator SANFORD. Mr. Chairman, let me add my word of thanks to the witnesses not only for your presence here but for your very thoughtful papers which will be a part of the record and are very helpful to our staff as we begin to work on this issue. I'm very grateful to you for taking the time to do all this work to help us come to a better solution.

[Whereupon, at 11:30 a.m., the hearing was adjourned.]

77-449 (68)

In New York, Governor Cuomo's proposed legislation[8] authorizes State-chartered banks and thrift institutions to invest up to 3 percent of their assets in insurance agencies or brokerages, provided the banks and thrifts offer "lifeline" banking services. Lifeline accounts provide consumers with basic banking services at a minimal cost, thus ensuring that we do not jeopardize the interests of small depositors in our efforts to achieve one-stop financial shopping. The Legislation would also authorize State-chartered banks and thrifts to act directly as insurance agents and brokers, and to offer insurance both at their existing branches and at other locations. The proposed legislation, as well as laws already in place, contain safeguards that address the concerns of those who have expressed doubts about banks as insurance agents and brokers.

A. Safeguards Against Tie-In Sales

Perhaps the most frequently cited potential abuse associated with banks selling insurance is that banks, because of their power to grant or deny credit, would be able to coerce prospective borrowers to purchase their insurance through the banks' owned or affiliated agent (or insurer).

The New York Insurance Law[9] already prohibits lenders from requiring the purchase of insurance in connection with a loan through a specified agent or from a particular insurer. The proposed legislation includes the following additional safeguards against tie-in sales:

* Lenders who sell insurance would be prohibited from soliciting insurance from prospective borrowers prior to approval of their credit application.

* Lenders would be required to provide a 30-day cancellation privilege for policies sold in connection with extensions of credit.

* Lenders would be required to provide a disclosure form to prospective borrowers, together with the credit application, that spells out the customer's rights in connection with the purchase of any insurance required as part of a loan transaction.

* Lenders would be required to accept any policy meeting the lender's objective and uniformly applied minimum standards relating to the coverage required.

* Lenders would be prohibited from engaging in delaying tactics that would penalize borrowers who obtained insurance coverage through agents or brokers or insurers of their own choice not affiliated with the lender.

* Lenders would be prohibited from charging unreasonable fees in connection with the substitution of an insurance policy.

Under the proposed legislation, the Superintendent of Insurance would have the authority to suspend or revoke a bank's insurance license if it engages in anti-competitive practices in the sale of insurance in connection with the making of loans. The Superintendent also would have the authority to obtain an injunction under the Insurance Law against such a bank and could request the Attorney General to bring a civil action on behalf of the people of the State for recovery of treble damages.[10]

At present, tie-in sales prohibitions in most states are not sufficient to deal with abuses that may arise should banks be permitted to actively market a variety of insurance products. It is essential that such measures be in place in each state at the time of implementation of any legislation allowing banks to sell insurance.

B. Customer Service and Protection

Governor Cuomo's proposed legislation provides that banks acting as insurance agents or brokers would be licensed and subject to regulation by the Insurance Department in the same manner as other insurance agents or brokers, and the sale of insurance by banks and their affiliates would be conducted only by individuals who are so licensed and regulated. Such a requirement would create a "level playing-field" for all participants and would eliminate any problems associated with dual regulatory authority.

To protect consumers from the sale of insurance by bank personnel untrained in insurance, the legislation would provide that during a three-year transition period each location at which a bank offers insurance to the public would be under the supervision of a licensed agent, located on the premises, who has worked as an agent for at least three years. It is important, I believe, that in an effort to enhance competition, the level of competence and expertise the public has come to expect from licensed brokers and agents not be compromised.

IV. MULTIPLE JURISDICTIONS

We presently have in place insurance regulatory agencies in 50 states, regulatory agencies for State-chartered banks and thrifts in 50 states, and regulation of federally-chartered banks and thrifts by several federal agencies. Given the multiplicity and differing scope of the various state and federal laws, have we given adequate thought to what will occur when we create a nexus among these systems? What kinds of jurisdictional conflicts, problems, ambiguities and gaps will occur?

Rather than simply pose a general question, I would like to illustrate the kinds of problems that can arise by using an example. While the issues raised are complex, they are fairly straightforward compared to the problems that may arise once there is general authorization for banks and insurers to enter one anothers' businesses.

In 1985, an out-of-state insurer applied for a license to conduct an insurance business in New York. The company had previously been approved to operate as a subsidiary of a federally-chartered bank by the Office of the Comptroller of the Currency (OCC). Some of the issues that were raised at that time included:

> **(1) Would New York's right to conduct an examination of any parent of a licensee under New York Insurance Law extend to a bank parent?**

The OCC advised that current federal law restricts examination of national banks to the OCC. The OCC was advised by the bank's counsel that the bank's policy would be to provide the state insurance regulator with whatever information the bank deems necessary. As a result, OCC advised that the need for a state insurance regulator to examine the bank is "obviated."

We do not acquiesce to OCC's conclusion that need for a state regulator to examine this bank is obviated as a consequence of the bank's policy to voluntarily provide all requested information. Such a conclusion not only conflicts with the authority granted by the provisions of New York Insurance Law, but may be viewed as an abdication by the Superintendent of his responsibilities. The power to make enquiry of, require reports from, and examine any company in the holding company system about activities affecting a licensed insurance company is vital. Expressions of cooperation by the OCC and the bank do not fulfill the state insurance regulators' responsibilities. Moreover, the notion that a bank would voluntarily furnish information that would indicate it has violated the law is, in my view, naïve.

> **(2) In the event of an insolvency of either the parent bank or the insurer subsidiary, who would control or take title to the subsidiary's assets?**

If an insurance company were to become insolvent, state insurance laws direct insurance regulatory authorities to take possession of the property of the insolvent insurer. It appears, however, that the Federal Deposit Insurance Corporation (FDIC), has a differing view. They informed the Department that, although they do not issue advisory opinions regarding hypothetical receivership matters, if the subsidiary was insolvent, the FDIC could "take steps to liquidate its assets."

If, on the other hand, the parent bank were declared insolvent, the FDIC indicated that they may (1) dispose of its interest in the subsidiary, (2) exercise its prerogatives as the subsidiary's majority shareholder to effect control of the subsidiary, or (3) bring the subsidiary's assets into the receivership estate. The third option would only be exercised, according to the FDIC, in the event that the subsidiary did not operate independently of the parent.

Since one of our major concerns over the years has been that insurers' assets be effectively walled off from the parent company, the FDIC's projected scenarios in the event of an insolvency are, to put it mildly, disturbing.

(3) Does the McCarren-Ferguson Act permit the Comptroller to share jurisdiction of the insurer subsidiary with state insurance regulators?

Based upon their review of the McCarren-Ferguson Act, the OCC opined that the Act imposes no bar to regulation of the subsidiary by both state insurance regulators and the Office of the Comptroller. Such regulation by both agencies would not "invalidate, impair, or supersede" state insurance laws. The OCC further advised that in the event that rules or procedures of both agencies apply in a given instance, the more conservative or restrictive approach would take precedence. With regard to financial examinations of the insurer, the OCC stated it would "invite" state regulators to coordinate examinations with OCC.

I find OCC's premise that regulation by both agencies (state and federal) would not "invalidate, impair, or supersede" state regulation insupportable in light of the responses to the two previous questions.

When divisions of regulatory authority are blurred as a result of overlapping jurisdictions, some banks and insurers will undoubtedly exploit gray areas of the law. At the same time, a regulator may find it easier to shift responsibility by pointing its finger in another agency's direction. In either event, effective regulation suffers. Therefore we must identify, with as much specificity as possible, likely problem areas so that they can be dealt with before, not after, legislation is passed.

V. GUARANTY FUNDS

Another area of concern of mine involves the meshing of insurance guaranty (or security) funds and insured bank deposit funds (FDIC, FSLIC). Insurance guaranty funds should be made more uniform among states and more comprehensive. The insolvency of a single multistate insurance company can be a complex, time-consuming and cumbersome matter. An insolvency involving a holding company group can be still more complex, as the Baldwin-United debacle proved. The formation of insurance-banking operations will add yet more layers of complexity with regard to the jurisdictions and coverages of such funds and their capacity to meet their obligations.

VI. CONCLUDING REMARKS

The Cuomo Administration and the New York Insurance Department have endorsed the modernization of New York laws to accommodate changing economic circumstances in the financial services sector. Should the federal government decide to do likewise, the message I would like to leave with you today is the need for strong regulatory safeguards. Solvency protection should include a strong holding companies act, legislation to prevent third-party conflicts of interest, and prudent investment caps. For insurance buyers, measures should be enacted to effectively prohibit lenders from coercing borrowers into buying insurance in connection with the granting of credit. Legislation should be carefully crafted so as not to create any significant regulatory gaps or overlaps that lead to confusion and conflict among jurisdictions. Lastly,

careful study should be made of insurance guaranty funds and insured bank deposit funds to ensure that insurance and banking customers will be equitably treated in the event insolvencies occur.

Again, I wish to express my appreciation for the opportunity to appear before you today.

FOOTNOTES

[1]The Commission's official name was the Temporary State Commission on Banking, Insurance and Financial Services.

[2]In 1987, Governor's Program Bills Nos. 30-34 reflected recommendations of the DeWind Commission.

[3]DeWind Commission Report, p. 166.

[4]DeWind Commission Report, p. 193.

[5]The two subsidiaries were Baldwin Life Insurance Company and the American Municipal Bond Assurance Corporation (AMBAC).

[6]Sloane, Leonard, "Baldwin Policyholders May Finally Get Funds," New York Times, October 14, 1986, p. D1.

[7]Financial guarantee insurance is currently covered by New York's Property/Casualty Insurance Security Fund (P/CISF). However, the Department has helped draft legislation that would remove such insurance from security fund protection on the grounds that the security fund was created to provide protection for unsophisticated purchasers of insurance. Purchasers of financial guarantee insurance know, or should know, the risks they are assuming.

[8]Assembly Bill 5965, Senate Bill 3428 (Governor's Program Bill No. 31).

[9]Section 2502.

[10]Where damages are nominal or impossible to ascertain, the proposed legislation provides for a penalty of up to $100,000. The Attorney General could also intervene in an action brought by policyholders for recovery of damages, or obtain other relief.

[11]Section 1504(b).